Post-Implementation Review

Leases (Topic 842)

801 Main Avenue, P.O. Box 5116, Norwalk, CT 06856-5116 | Tel **203-847-0700** | Email **director@fasb.org** | **fasb.org**

We are pleased to share with the Financial Accounting Foundation (FAF) Board of Trustees and our stakeholders the FASB Post-Implementation Review Report: Topic 842—Leases (the leases standard). The Post-Implementation Review (PIR) process is an important quality-control mechanism that allows the FASB to support high-quality application of the leases standard and evaluate whether it is achieving its stated objectives in ways that justify the costs of providing the information required. The primary objective of the leases standard was to provide investors and other financial statement users with relevant information by requiring that lessees recognize lease assets and lease liabilities that arise from all leases on the balance sheet and to disclose key information about their lease transactions. In addition, the leases standard sought to more closely align lessor requirements with the comparable guidance in Topic 606, Revenue from Contracts with Customers, and Topic 610, Other Income, and responded to the request from the U.S. Securities and Exchange Commission (SEC) staff in its *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (Report On Arrangements with Off-Balance Sheet Implications) to reconsider the previous lessee accounting guidance.

This summary report and the accompanying detailed report in Appendix A discuss how the FASB staff conducted the Leases PIR process, which included outreach with over 1,600 individuals with diverse backgrounds, key implementation support provided throughout the adoption of the leases standard, and using what was learned during the PIR process to improve the leases standard and, more broadly, the standard-setting process.

The Leases PIR process began with the issuance of the leases standard in 2016 and included three stages:

- Post-issuance date implementation monitoring (began in 2016 upon issuance of the standard)
- Post-effective date evaluation of costs and benefits (began after the 2019 effective date for public entities and the 2022 effective date for nonpublic entities)
- Summary of research and reporting.

The FASB staff and Board engaged in many activities to support the post-implementation review of the leases standard. This included addressing implementation issues submitted through the FASB's Technical Inquiry Service; engaging with all stakeholder types, including at FASB advisory group meetings and public roundtables; issuing Accounting Standards Updates to clarify or make targeted improvements to the standard; and holding public Board meetings to discuss stakeholder feedback and PIR updates.

Lessee Accounting Requirements

In general, the leases standard achieved the objective of providing investors and other financial statement users with more useful information about a lessee's leasing activities. Although feedback from investors on the usefulness of lessees recognizing lease assets and lease liabilities is mixed, for many investors the lease assets and lease liabilities are a useful starting point that improves comparability of leases across reporting entities. The leases standard also addressed the recommendation of the SEC staff in its *Report On Arrangements with Off-Balance Sheet Implications*. However, the costs to initially implement the lessee requirements along with the ongoing costs to apply those requirements were significantly higher than the Board expected at issuance, primarily because entities' existing systems and processes were often not able to account for operating leases on the balance sheet. In addition, significant time and effort were expended to identify an entity's lease arrangements and incorporate the lease terms into their accounting systems and processes.

Lessor Accounting Requirements

Investors and other users of financial statements are generally satisfied with the information provided under the lessor accounting requirements. In addition, because many of the lessor accounting requirements were largely unchanged from legacy generally accepted accounting principles (GAAP), most lessor entities did not incur significant costs to either initially implement those requirements or apply the requirements on an ongoing basis. However, after the issuance of the standard, the Board issued several Accounting Standards Updates to make lessor financial accounting outcomes more consistent with legacy GAAP.

Standard-Setting Process

We recognize our stakeholders' commitment to undertake a high-quality implementation of a major accounting standard and the level of effort necessary for stakeholders of varying sizes to undertake a significant accounting change. The PIR process provided feedback on improvements to the standard-setting process in the following areas:

- System and process assumptions
- Transition guidance
- Effective dates
- Converged standard setting
- Defining the objective of a project.

While the Leases PIR process is complete, the FASB's work supporting the application of the leases standard is not. We will continue to monitor and, if appropriate, make improvements to the standard.

In closing, we want to thank our FASB colleagues, past and present, who participated in this journey, as well as the FAF Trustees and staff who continue to oversee and support the PIR process. We thank all of our stakeholders who took the time to share with us their expertise, insights, and professional experiences to help us better understand the standard's effect and whether it fulfilled the Board's expectations. We encourage you to continue to engage with us to help ensure all of our standards and activities continue to evolve to meet the needs of our capital markets.

Richard R. Jones
Chair,
Financial Accounting Standards Board

Jackson M. Day
Technical Director,
Financial Accounting Standards Board

Post-Implementation Review Summary Report

Topic 842—Leases

Leases PIR Process Overview

The Post-Implementation Review (PIR) process is an evaluation of whether a standard is achieving its objective by providing investors and other financial statement users with relevant information in ways that justify the cost of providing it. The PIR process is an important quality-control mechanism built into the Board's standard-setting process that begins after the issuance of select standards and is conducted under the oversight of the FAF Board of Trustees. The PIR process assists the Trustees in evaluating the effectiveness of the standard-setting process.

The objectives of the Leases PIR process include:

Objectives

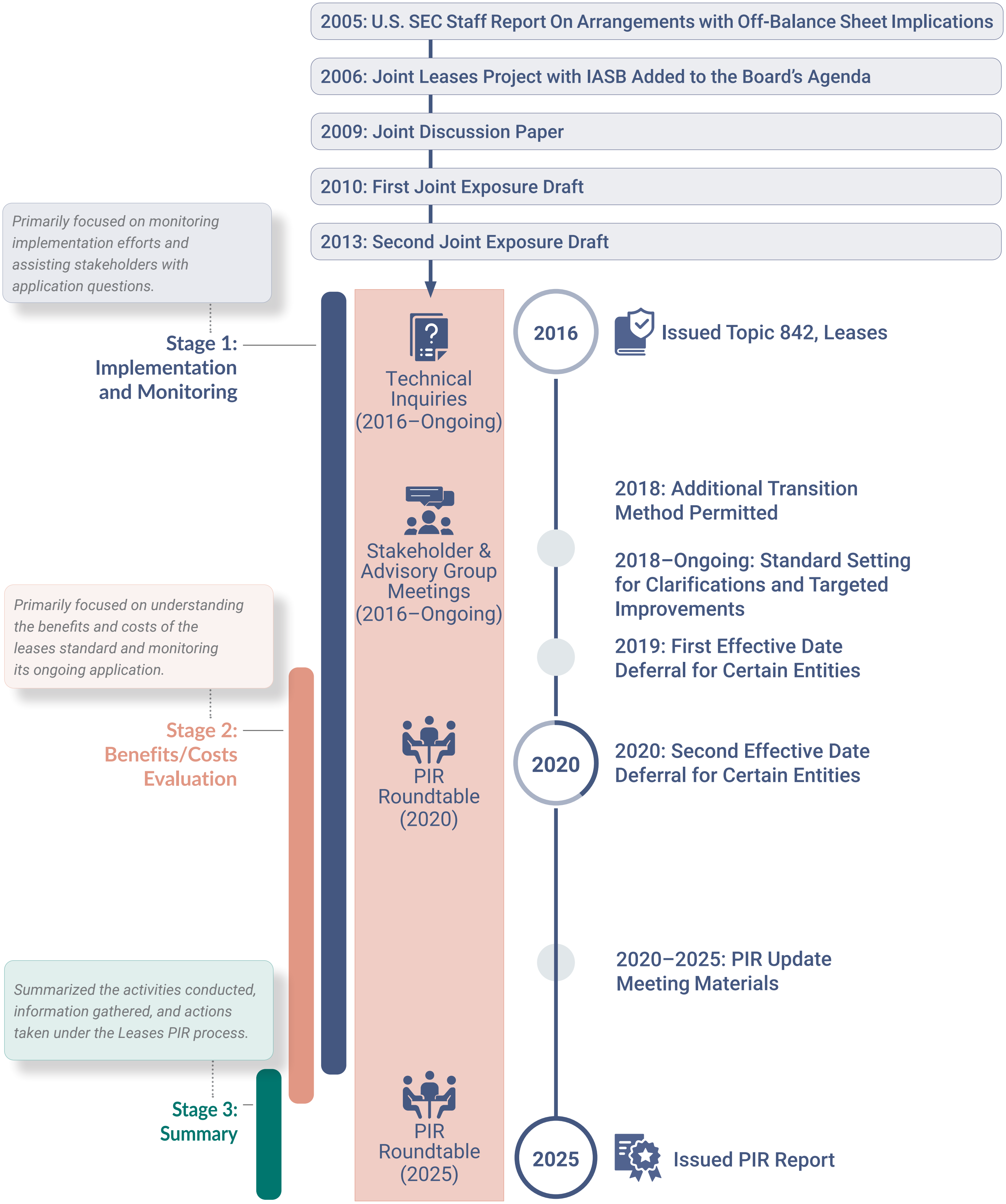
- Determine whether the leases standard is accomplishing its stated purpose
- Evaluate the leases standard's implementation and continuing compliance costs and related benefits
- Provide feedback to improve the standard-setting process.

The Leases PIR process involved extensive research and outreach, including the following key activities:

Key Activities

- Engaged with over 1,600 individuals with diverse backgrounds in over 280 stakeholder meetings and 77 advisory group meetings
- Prepared nearly 70 documents, including Board meeting memos, Exposure Drafts, and Accounting Standards Updates
- Responded to over 370 questions through the Technical Inquiry Service
- Held over 30 Board meetings on implementation matters, subsequent standard setting, and PIR updates.

The following timeline presents the different phases of the Leases PIR process and some of the Board's key activities:



As a result of the activities conducted during the Leases PIR process, the following effects of the leases standard and implementation efforts were observed:

Effects of the Leases Standard

- In general, the standard provided more decision-useful information in lessee financial statements by recognizing lease assets and lease liabilities on the balance sheet and disclosing key qualitative and quantitative information about lease transactions.
- Although feedback from investors on the usefulness of lessees recognizing lease assets and lease liabilities is mixed, for many investors the recognized lease assets and lease liabilities are a useful starting point that improves comparability of leases across reporting entities.
- The standard addressed the request from the U.S. Securities and Exchange Commission (SEC) staff in its *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (Report On Arrangements with Off-Balance Sheet Implications) to reconsider the accounting guidance for leases.
- Although converged in many areas, generally accepted accounting principles (GAAP) and IFRS Accounting Standards have not converged in some key areas, including certain aspects of the lessee accounting model.
- Many lessees noted that implementing Topic 842 improved their understanding of their lease contracts and strengthened their internal controls around leasing and procurement processes.
- Investors are generally satisfied with the information provided by Topic 842 lessor requirements.
- The standard aligned lessor accounting more closely with revenue recognition guidance.

Implementation Efforts

- Most lessees incurred significant costs to enhance existing systems and processes and needed additional resources to apply the leases standard.
- Significant implementation support, including subsequent standard setting, was needed to facilitate lessees’ adoption of Topic 842.
- Many entities comprehensively reviewed contracts to identify the complete population of leases and lease provisions to be incorporated into accounting records and to be recognized on the balance sheet.
- Many entities made significant enhancements to their contract management functions resulting in new processes, systems, and controls.
- Significant implementation support and subsequent standard setting were needed so that the financial reporting outcomes for lessors were more consistent with those under legacy GAAP.
- Most lessors incurred minimal costs to apply Topic 842.

Engaging Stakeholders

Stakeholder feedback is critical to both the standard-setting process and the PIR process. The staff strives to access a broad spectrum of stakeholder perspectives in an unbiased, objective manner. During the Leases PIR process, broad stakeholder feedback was solicited to facilitate timely support for the high-quality implementation of the leases standard and a well-informed evaluation of its actual benefits and costs.

Reaching Stakeholders with Diverse Perspectives

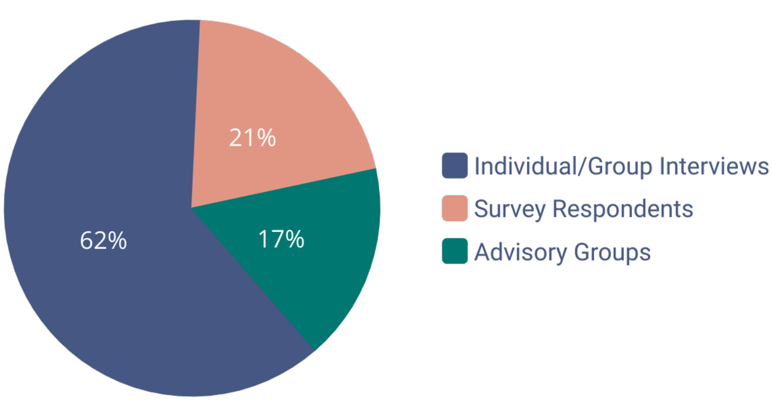
From 2016 to 2025, the staff engaged with over 1,600 individuals, including:

- Investors, including buy-side portfolio managers, sell-side analysts, accounting analysts, credit rating agency analysts, lenders, sureties, and other capital providers (for example, private equity)
- Preparers, including public, private, and not-for-profit (NFP) entities, representing a variety of industries and sizes
- Practitioner firms of all sizes
- Other stakeholders, such as trade groups and advocacy groups, state CPA societies, regulators, other standard setters, and academics.

What Kind of Stakeholders Did We Engage With?

In our effort to seek a wide range of stakeholder perspectives, we heard from stakeholders through individual interviews, group discussions, advisory group meetings, two public roundtables, surveys, webcasts, and conferences.

How Did We Hear from Stakeholders?



Stakeholder feedback during the early stages of the PIR process is critical to facilitate timely support for high-quality implementation of the standard.

What Stakeholders Say about the Leases Standard

The Board added the Leases project to its technical agenda in response to stakeholders recommending that changes be made to facilitate greater transparency in financial reporting of all leases. In particular, the SEC staff in its *Report On Arrangements with Off-Balance Sheet Implications* recommended that the accounting guidance for leases be reconsidered in light of the large volume of off-balance sheet future cash obligations.

BENEFITS

- Although feedback from investors on the usefulness of lessees recognizing lease assets and lease liabilities was mixed, almost all investors agree that the disclosures provided under Topic 842 are an improvement to those provided under legacy GAAP.
- Other stakeholders, including practitioners and preparers, noted that the lease modification guidance, sale and leaseback guidance, and built-to-suit guidance are a significant improvement over legacy GAAP.
- Many stakeholders said that the leases standard results in enhanced internal controls around leasing activities and helps entities to better understand their exposure to leases.
- Investors are generally satisfied with the lessor information reported under Topic 842.

COSTS

- The implementation and ongoing costs to apply the standard are significantly greater than anticipated. There was a significant gap between stakeholder assertions received before the issuance of the leases standard that existing systems and processes were adequate to adopt Topic 842 and actual outcomes.
- Many entities needed additional resources to understand, initially implement, and apply Topic 842 on an ongoing basis. For example, many lessees comprehensively reviewed their existing contracts to identify a complete population of leases and incorporated the terms of those leases into accounting records.
- Stakeholders noted that more robust internal controls and processes had to be established to comply with Topic 842.
- Lessors have generally not experienced challenges applying the leases standard because the Board undertook standard setting to preserve many aspects of previous financial reporting outcomes.

Overall, stakeholder feedback on the leases standard was mixed. In general, investors observed that the recognition of all leases on the balance sheet and the qualitative and quantitative disclosures about an entity's leasing arrangements provide decision-useful information. Many preparers experienced significant costs to apply the leases standard initially and on an ongoing basis, most notably because their existing systems and processes were not equipped to account for all of their leases on the balance sheet. Additionally, preparers indicated that additional resources, such as additional staff and systems, were needed to apply aspects of the standard such as identifying leases, incorporating the terms of existing leases into the system, and determining the discount rate.

> *Many preparer lessees experienced significant costs to apply the leases standard initially and on an ongoing basis.*

The Board did not fully consider those costs during its deliberations in part because many preparers communicated that they expected to apply the new requirements using systems and processes similar to those used under legacy GAAP. Many of the fundamental concepts in Topic 842 are similar to those in legacy GAAP, and entities needed information to apply those concepts to comply with previous disclosure requirements. Therefore, the Board expected that the level of effort to gather the information to apply the leases standard would not be significant. Instead, significant time and effort were expended to identify and validate the population of leases and lease provisions to incorporate into the accounting records and systems what was previously assembled for disclosure purposes outside of those records and systems.

The Board provided significant implementation support and undertook subsequent standard-setting activities to facilitate a high-quality adoption of the standard, including simplifying the transition requirements and deferring the effective date.

Overall, stakeholder feedback on the lessor requirements has been generally positive. Investors are generally satisfied with the lessor information reported under Topic 842.

The lessor requirements in Topic 842 were intended to be generally consistent with legacy GAAP but more closely aligned with the revenue recognition guidance in Topic 606, Revenue from Contracts with Customers, and Topic 610, Other Income.

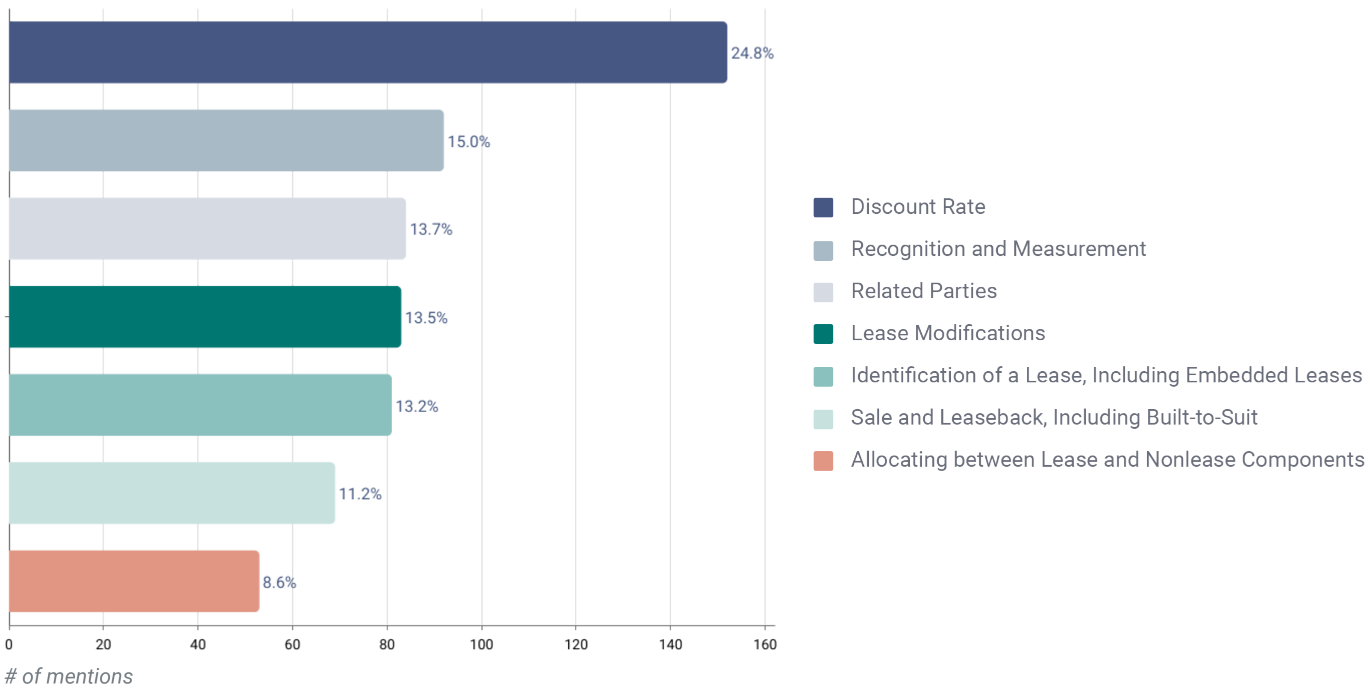
> *Overall, stakeholder feedback on the lessor requirements has been generally positive. Investors are generally satisfied with the lessor information reported under Topic 842.*

The Board issued several Accounting Standards Updates affecting the lessor requirements after the issuance of the leases standard to more closely align the financial reporting outcomes with legacy GAAP.

Lessee Challenges

Stakeholders that participated in the Leases PIR process provided feedback on areas of the guidance that were challenging to apply. The following chart displays the seven areas of lessee accounting that were mentioned most frequently by stakeholders as challenging to apply:

Challenging Areas Identified by Lessees



PIR research indicated that many of those challenges were mitigated by implementation support from the Board and staff or reflected the application of the guidance to nuanced or complex circumstances. Additionally, because many of the fundamental concepts in Topic 842 are similar to or unchanged from legacy GAAP, some of the identified areas of challenge existed under legacy GAAP. Those concepts gained significance when lease assets and lease liabilities were recognized on the balance sheet. The challenges generally resulted from the following factors:

- Because operating leases are now recognized and measured by lessees on the balance sheet, entities are reviewing contracts as part of routine processes to determine whether a lease exists and, if so, to identify the separate lease and nonlease components in the contract. Additionally, fundamental aspects of the lessee guidance, such as the discount rate, lease term, and lease payments, are subject to more rigorous scrutiny when they affect recognized lease assets and lease liabilities.

- For certain areas such as lease modifications, sale and leaseback transactions, and built-to-suit arrangements, while the accounting guidance was significantly changed by the leases standard, the application of that guidance continues to require significant judgment.

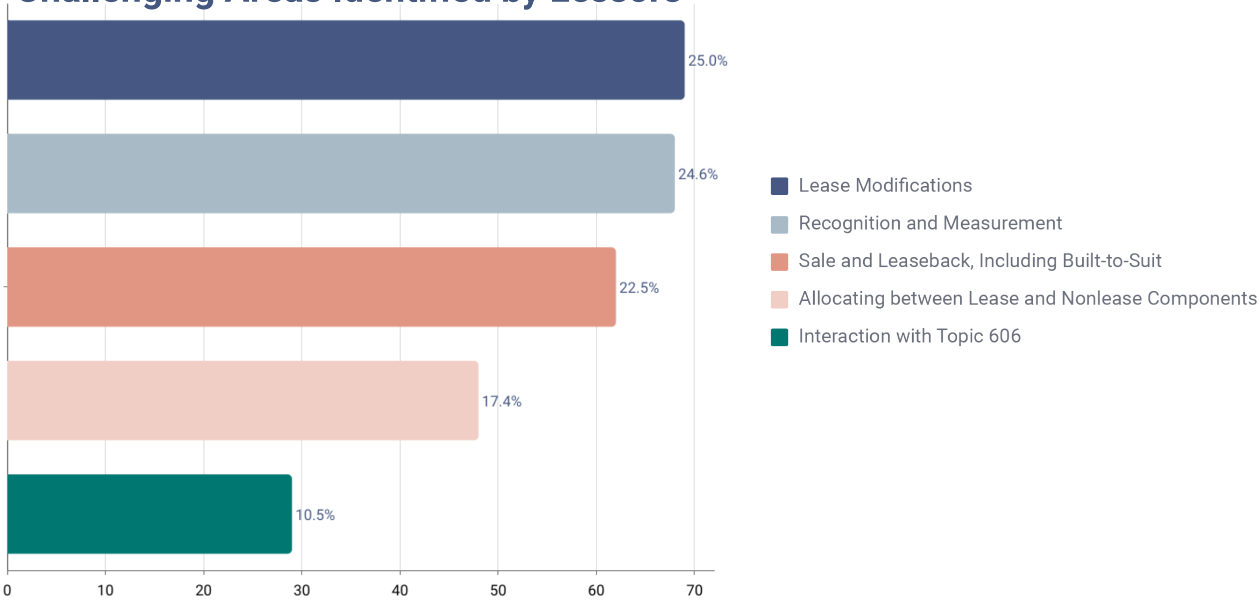
Most stakeholders indicated that, currently, no significant changes are needed to the fundamental aspects of the leases standard. Many stakeholders noted that making fundamental changes would be disruptive, particularly because systems and processes have been established to apply the requirements at significant cost and effort. However, certain private company stakeholders continue to request that the Board consider additional changes to the lessee accounting model to reduce ongoing compliance costs.

Lessor Challenges

The Board intended for lessor accounting requirements to be generally consistent with legacy GAAP. However, there were changes including the elimination of leveraged leases guidance and real-estate-specific accounting requirements, and changes to the definitions of sales-type and direct-finance leases.

Lessor stakeholders raised a number of issues during their implementation of the standard and requested that the Board amend the leases standard to retain certain financial reporting outcomes achieved under legacy GAAP. In addition, although an objective of Topic 842 was to more closely align the lessor requirements with the revenue recognition guidance in Topic 606 and Topic 610, some stakeholders observed that the outcomes did not fully reflect that alignment. The following chart displays the five areas of lessor accounting that were mentioned most frequently by stakeholders as challenging to apply:

Challenging Areas Identified by Lessors



# of mentions

PIR research indicated that those challenges were substantially mitigated by implementation support from the Board and staff, including issuing targeted improvements to more closely align with previous financial reporting outcomes. Certain differences continue to exist between the revenue recognition requirements in Topic 606, Topic 610, and Topic 842. Broadly, stakeholders indicated that no significant changes are currently needed to the lessor accounting model in Topic 842.

PIR Highlights

Since the issuance of the leases standard in February 2016, the Board has proactively supported the implementation and ongoing application of the standard. Additionally, the Board and staff conducted outreach with all stakeholder types to understand the effectiveness of the leases standard and its related benefits and costs.

Significant PIR Activities

In monitoring implementation and ongoing application of the leases standard and to evaluate the expected benefits and expected costs of the standard, PIR activities performed by the Board and staff to date include the following:

- Held over 280 stakeholder meetings to discuss leases implementation and ongoing application issues
- Conducted outreach with investors that included sell-side analysts, buy-side analysts, credit rating agencies, and others that follow a wide range of entities in a variety of industries and sectors
- Conducted surveys of public and nonpublic entities to understand the initial and ongoing costs of applying the leases standard, including entities of various sizes and from a variety of industries
- Discussed leases implementation and ongoing application issues at 77 advisory group meetings
- Responded to over 370 technical inquiries, a significant portion of which related to lessee accounting and transition
- Discussed leases implementation and application issues at over 30 public Board meetings, including project activities associated with amending Topic 842
- Held two public roundtables, in 2020 and 2025, which included investors and other users, practitioners, and preparers representing public and nonpublic entities from a variety of industries
- Evaluated 12 agenda requests and 12 unsolicited comment letters related to the leases standard
- Issued eight Accounting Standards Updates to clarify and/or modify Topic 842
- Issued a Staff Q&A in April 2020 on accounting for lease concessions in response to concerns arising as a result of the global pandemic

- Conducted education initiatives for stakeholders after issuance of the leases standard that included webcasts and presentations
- Reviewed 33 academic research papers on the effects of the lessee accounting requirements under the leases standard.

Private Company and Not-for-Profit Entity Activities

The FASB also performed the following activities related to private companies and NFP entities:

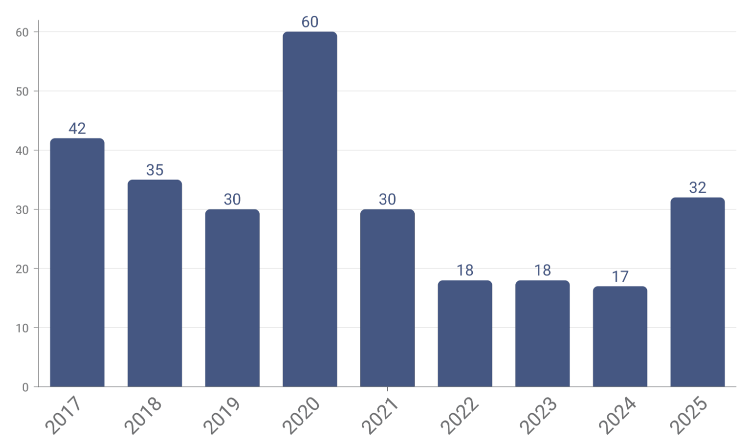
- Conducted outreach with private company preparers from various sizes of entities and a variety of industries, and nonpublic entity practitioners
- Conducted outreach with nonpublic entity financial statements users, including lenders, sureties, private equity, venture capital, and bond rating agencies
- Issued two Accounting Standards Updates to defer the leases standard for private companies and certain NFP entities
- Traveled throughout the United States to conduct town hall and liaison meetings with private company stakeholders
- Supported the Private Company Council's (PCC) activities by dedicating resources to its leases working group.

Additional information on selected significant PIR activities can be found below.

FASB Stakeholder Meetings

During the Leases PIR process, the staff held over 280 stakeholder meetings to discuss the implementation of the leases standard and ongoing application issues. Many different types of stakeholders were involved with those meetings, including investors and other users, public and nonpublic entity preparers representing a variety of industries and sizes, practitioners of all sizes, trade associations, state CPA societies, regulators, international accounting standard setters, and others. The meetings covered a variety of lease implementation and ongoing application issues.

Stakeholder Meetings by Year



FASB Advisory Groups

The primary role of the advisory groups is to share views and experiences with the Board related to current and future projects and the implementation of new standards.

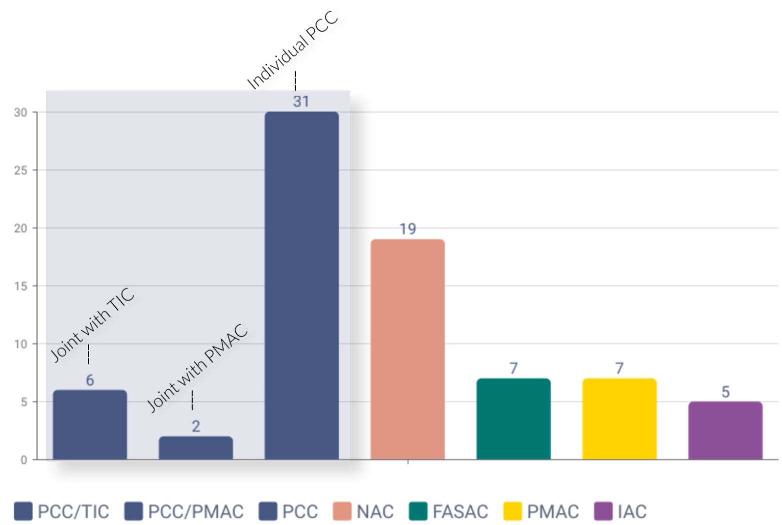
From 2016 to 2025, the staff participated in 77 advisory group meetings on the leases standard.

The staff obtained the perspectives of nonpublic entities on the leases standard as part of:

- Thirty-nine meetings with the PCC, including joint meetings with the AICPA's Private Companies Practice Section Technical Issues Committee (TIC) and Public Markets Advisory Committee (PMAC).[1] The leases standard has been discussed at over 75 percent of the PCC's meetings since the standard was issued.
- Nineteen meetings with the Not-for-Profit Advisory Committee (NAC).

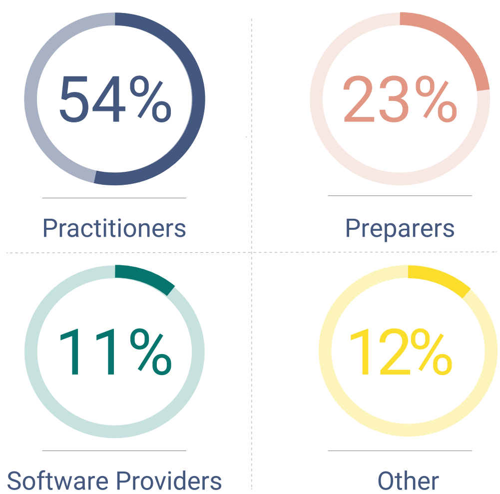
The staff also sought perspectives on the leases standard as part of:

- Seven meetings with the Financial Accounting Standards Advisory Council (FASAC).
- Seven regular meetings with the PMAC.
- Five meetings with the Investor Advisory Committee (IAC).



Technical Inquiry Service

What Kind of Stakeholders Submitted Inquiries?



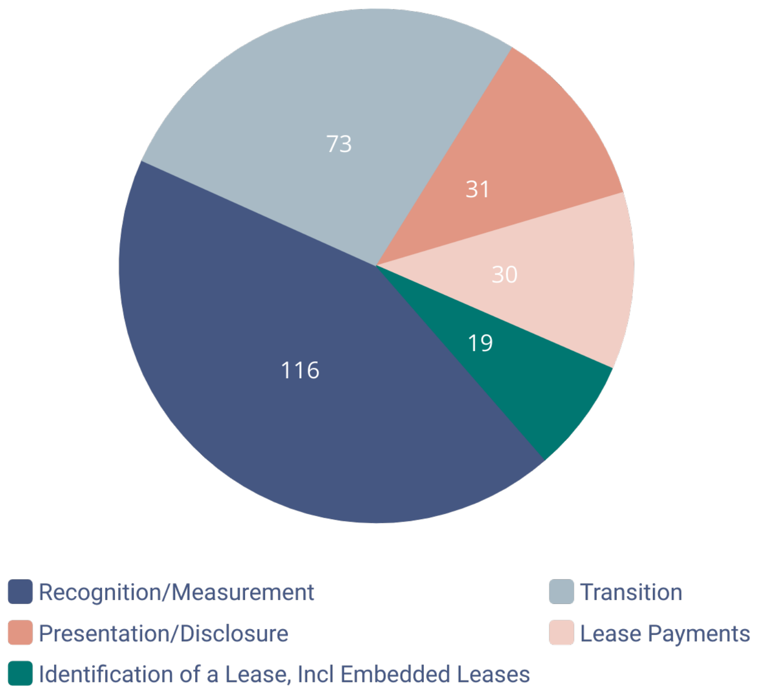
"Other" includes the following: academics, trade groups, regulators, and others.

The objective of the FASB's Technical Inquiry Service is to clarify existing guidance or provisions within the *FASB Accounting Standards Codification*®.

Throughout the Leases PIR process, the staff responded to over 370 technical inquiries and provided necessary support on a timely basis, contributing to a high-quality implementation of the leases standard.

[1] The Public Markets Advisory Committee was formerly known as the Small Business Advisory Committee.

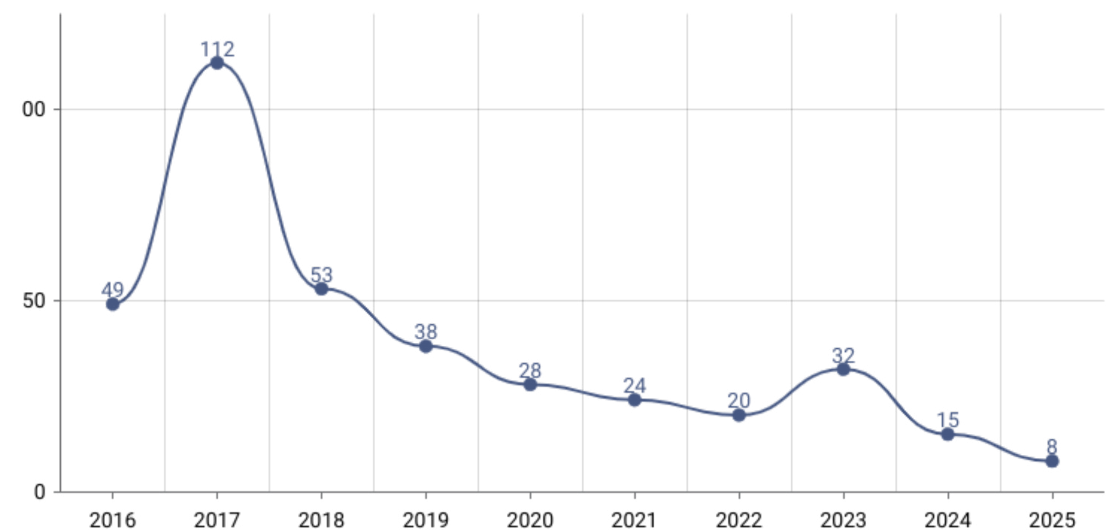
Key Inquiries by Subject Area



Stakeholders submitted inquiries on various aspects of the leases standard. Most inquiries related to recognition and measurement and transition.

The use of the Technical Inquiry Service fluctuated during the PIR period. Stakeholders submitted the most inquiries in 2017 after the issuance of the leases standard as public entities began implementation. The number of inquiries also rose in 2023 as nonpublic entities completed their implementation of the standard.

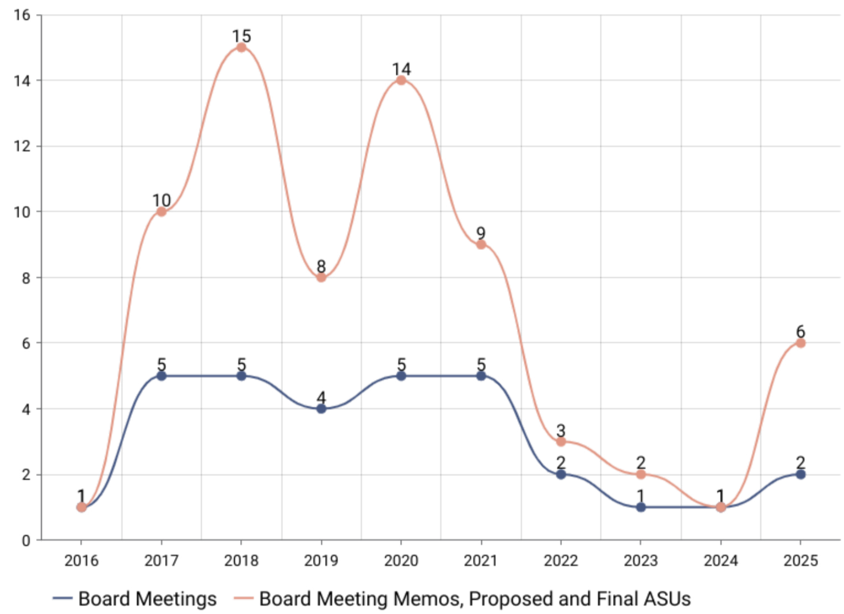
How Many Inquiries Did the Staff Respond to over the Years?



Board Meetings and Related Documents

There were over 30 public Board meetings held throughout the PIR process during which the Board discussed stakeholder feedback and deliberated on amendments to Topic 842. The staff also provided the Board with updates on PIR activities performed on the leases standard. The staff prepared nearly 70 documents to support the Board's activities, including 8 Accounting Standards Updates for clarifications and targeted improvements in various areas and 2 Accounting Standards Updates for effective date deferrals for certain nonpublic entities (see Appendix B).

Board Meetings and Related Documents



Because the Leases project was initiated as a joint project of the FASB and the International Accounting Standards Board (IASB), many aspects of Topic 842 are similar to IFRS 16, *Leases*. Since issuance of those standards, the two organizations continue to discuss each Board's progress and findings on their respective PIRs as part of their annual joint education meetings.

The Boards also encouraged academic research to assess certain aspects of the leases standard and provide information about the effectiveness of the standard during the Accounting for an Ever-Changing World conference in 2022 jointly hosted by the FASB and the IASB.

Improvements to the Standard-Setting Process

The Leases PIR process provided the Board with timely feedback to improve the standard-setting process in the following areas:

System and Process Assumptions

Stakeholder feedback indicated that lessees would be able to apply the leases standard utilizing their existing systems and processes. The Board used that feedback in deciding on fundamental aspects of the lessee model. There was a significant gap between what was communicated to the Board about the adequacy of systems and processes and what was experienced by preparers. Stakeholders generally looked to purchase new software and were faced with limited software availability and functionality and a general lack of resources to support implementation.

In addition, preparer feedback underestimated the additional costs incurred for entities to fully and accurately identify their population of leases and lease provisions and incorporate those items, including disclosure of information that may not have previously been part of their accounting systems and processes, into their accounting systems and processes.

In the future, the standard-setting process should carefully weigh stakeholder feedback about the expected costs of applying a new comprehensive recognition and measurement model with the expected benefits. A particular focus should be on the need and availability of software solutions, as well as processes to incorporate new information into accounting systems and processes.

Transition Guidance

Transition alternatives and practical expedients that were intended to be helpful in easing the burden of transition resulted in added complexity by permitting numerous accounting alternatives that require detailed tracking for years beyond the adoption date.

In the future, the standard-setting process should consider whether transition alternatives create inherent complexity for stakeholders in evaluating the effect of implementation, including the effects of multiple transition options and the expected benefits and expected costs of the transition requirements.

Effective Dates

In response to stakeholder feedback, the Board deferred the effective date of the leases standard twice—in 2019 and again in 2020 for nonpublic entities.

Since the issuance of the leases standard, the staff implemented new processes to better anticipate the length of time that it will take for a final standard to be issued and adopted and better evaluate how that timing affects the selection of the effective date.

Converged Standard Setting

The FASB and the IASB collaborated extensively between 2006 and 2016 to develop a converged leases standard, the objective of which was to improve financial reporting of leasing activities and achieve global consistency.

54 joint meetings with more than 290 memos

One joint Discussion Paper (2009), and 2 Joint Exposure Drafts (2010 and 2013) with more than 1,700 comment letters

Although the FASB devoted a significant amount of time and effort to develop converged requirements, the Boards diverged in some key areas. Throughout the deliberations of the project, the FASB's and the IASB's stakeholders' views were different, and that feedback eventually resulted in certain fundamental differences between the two standards.

The process to develop converged guidance, which requires agreement of two separate Boards, takes a significant amount of additional time and adds cost and complexity to the standard-setting process. The benefits and costs, and the timeliness of standard setting, should be considered if the Board contemplates deliberating standards jointly with the IASB in the future.

Since the issuance of Topic 842, the staff and the Board have regularly communicated with the IASB and its staff on the progress of the Leases PIR process, including seven public joint education meetings between 2018 and 2025.

Defining the Objective of a Project

Throughout the active deliberations of the Leases project, multiple exposure documents were issued that reflected major variations in the objective of the project for both lessor and lessee accounting compared with the eventual changes in Topic 842.

The length of time to complete the active deliberations, the turnover of FASB members during that period, and limited stakeholder agreement with the Board's objectives throughout the project meant that vastly different financial reporting outcomes were pursued in those exposure documents.

The significant accounting changes proposed in those exposure drafts for both the lessee and lessor accounting models were transformative to lease accounting. For some stakeholders, it was unclear what objective the Board set out to achieve in those exposure drafts and how the proposals responded to shortcomings that investors and other stakeholders had identified with legacy GAAP.

Furthermore, the multiple exposure documents affected the overall timing of standard setting and raised challenges in evaluating stakeholder feedback. For example, preparer feedback may have been influenced by the view that a proposal was less onerous than a prior exposure draft.

Since the issuance of Topic 842, new processes have been implemented at the staff and Board levels to better define the objective of a project during the research phase and to obtain stakeholder input on the objective earlier within a project.

PIR Summary

Overall Conclusions

On the basis of the activities conducted under the Leases PIR process, the staff reached the following conclusions on Topic 842 and the standard-setting process:

- Topic 842 accomplishes its primary objective that lessees recognize the rights and obligations arising from leases in the statement of financial position. Topic 842 responded to the request from the SEC staff in its *Report On Arrangements with Off-Balance Sheet Implications* to reconsider the previous accounting guidance for leases.
- Although certain implementation challenges were experienced for both lessees and lessors in the initial adoption of Topic 842, the Board provided support throughout the implementation period, including issuing amendments on targeted improvements and clarifications. The benefits of Topic 842 are generally consistent with what the Board intended and stakeholders expected at the time that the leases standard was issued, as documented in the basis for conclusions.
- For lessees, the costs of initial adoption of Topic 842 were not consistent with what the Board expected when the leases standard was issued. Furthermore, the ongoing costs of the leases standard have been generally higher than what the Board anticipated at the time the leases standard was issued. The Board will monitor feedback from stakeholders on the costs of applying the leases standard and will consider future opportunities to reduce the ongoing costs of the leases standard where appropriate, including through the activities of the PCC.
- Opportunities were identified to improve the standard-setting process, including feedback on system and process assumptions, transition guidance, effective dates, converged standard setting, and defining the objective of a project.

What's Next

Upon concluding the Leases PIR process, the staff has not identified any matters that warrant immediate standard-setting action on Topic 842. The staff will:

- Continue to support the application of Topic 842 primarily through the Technical Inquiry Service
- Assess any need for targeted improvements to Topic 842 arising from stakeholder feedback, future agenda requests, or recommendations of the PCC
- As part of the general standard-setting process, monitor for emerging practice issues or application issues related to the leases standard that should be considered by the Board.

In addition, the staff and the Board will continue to incorporate the feedback obtained from the Leases PIR process to improve future standard-setting activities.

See Appendix A for the Post-Implementation Review Detailed Report.

Post-Implementation Review Detailed Report

Topic 842—Leases

TABLE OF CONTENTS

Introduction

Overview

The Post-Implementation Review (PIR) process is an evaluation of whether a standard is achieving its objective by providing financial statement users with relevant information in ways that justify the cost of providing it. The PIR process is an important quality-control mechanism built into the FASB's standard-setting process, which begins after the issuance of select standards. During the PIR process, the Board solicits and considers diverse stakeholder input and other research to evaluate the standards that are issued and whether there are areas of improvements that the Board should address.

The PIR process is part of the Financial Accounting Foundation's (FAF) Board of Trustees' oversight responsibilities for the FASB and the Governmental Accounting Standards Board (GASB). The PIR process assists the Trustees in evaluating the effectiveness of the standard-setting process for both the FASB and the GASB.

The Leases PIR began in 2016 after the issuance of Accounting Standards Update No. 2016-02, *Leases (Topic 842)*. The leases standard was effective for public entities in calendar-year 2019 and for all other entities in calendar-year 2022. The Leases PIR process encompasses many different activities to support high-quality implementation of the leases standard and to evaluate the effectiveness of the leases standard and its related costs and benefits.

The Leases PIR report includes this detailed report and the summary report. The detailed report is intended to provide additional insight into the Leases PIR process.

General Background on the PIR Process[1]

PIR Objectives

The PIR process has three main objectives:

1. To determine whether a standard is accomplishing its stated purpose. This includes assessing whether:
    a. The standard resolved the issues underlying its need.
    b. Decision-useful information is being reported to, and used by, investors, creditors, and other users of financial statements.
    c. The standard is operational; that is, stakeholders can apply the standard as intended, the standard is understandable, and preparers are able to report the information reliably.
    d. Any significant unexpected changes to financial reporting or operating practices resulted from applying the standard.
    e. Any significant unanticipated consequences resulted from applying the standard.

[1] FASB's website (https://www.fasb.org/about-us/post-implementation-review-process).

2. To evaluate the selected standard's implementation and continuing compliance costs and related benefits. This includes assessing whether:
   a. Implementation and continuing compliance costs are consistent with the costs that the Board considered and stakeholders expected.
   b. Benefits are consistent with what the Board intended and stakeholders expected.
3. To provide feedback to improve the standard-setting process. This includes assessing whether the results of the review suggest that improvements are needed.

PIR Process

The PIR process comprises three stages.

Stage 1: Post-Issuance Date Implementation Monitoring

This stage begins immediately after the issuance of the standard. During the post-issuance date implementation monitoring period (and before the effective date), the Board will:

1. Actively monitor practice as stakeholders prepare for initial implementation of the standard
2. Develop and disseminate implementation guidance and educational materials
3. Communicate and perform outreach with stakeholder organizations, including outreach with the academic community (leveraging advisory councils, committees, and resource groups where applicable) to generate interest in research activities associated with the standard that is the subject of the PIR process.

After the effective date of the final standard, the staff will perform an archival review of financial reports and survey financial statement preparers (with the assistance of the academic community when needed).

Stage 2: Post-Effective Date Evaluation of Expected Costs and Expected Benefits

This stage begins after the effective date of the final standard. Stage 2 activities included:

1. Understanding the costs that an entity incurred in applying the standard as well as the costs that investors and other users incurred in analyzing and interpreting the information that the standard provides
2. Understanding the benefits of the standard provided to investors and other users as well as to entities
3. Monitoring the ongoing application of the standard.

In this stage, academic research may be sponsored or encouraged to assess certain aspects of the standard to provide information on the effectiveness of the standard.

Stage 3: Summary of Research and Reporting

Following the completion of Stages 1 and 2, the Board summarizes its research in a final report. The final report is a culmination of previous periodic updates and describes the activities conducted and actions taken to address any identified issues. In addition, a memorandum summarizing the PIR findings is prepared and discussed by the Board at a public meeting.

Oversight of the PIR Process

The PIR process is subject to FAF Board of Trustees oversight throughout all three stages.

The staff reports on the progress of PIR projects during the Board's public meetings and reports regularly to the Standard-Setting Process Oversight Committee (SSPOC) of the FAF Board of Trustees. The final PIR report is reviewed by the SSPOC and published on the FASB website.

Background on Topic 842, Leases

Entities enter into leases as a means to gain access to assets, obtain financing, and/or reduce an entity's exposure to the full risks of asset ownership. Previous accounting guidance for leases was criticized for failing to meet the needs of financial statement users because it did not always provide a faithful representation of leasing transactions.

In 2005, the staff of the U.S. Securities and Exchange Commission (SEC) issued *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (Report on Arrangements with Off-Balance Sheet Implications), to the United States Congress. See Appendix C for excerpts from the report on the recommendations related to standards on accounting for leases. The report addressed two primary questions: (1) the extent of off-balance sheet arrangements, including the use of special-purpose entities, and (2) whether financial statements of issuers transparently reflect the economics of off-balance sheet arrangements. Regarding leases, the report recommended that the accounting guidance be reconsidered and stated:

> The current accounting for leases takes an "all or nothing" approach to recognizing leases on the balance sheet. This results in a clustering of lease arrangements such that their terms approach, but do not cross, the "bright lines" in the accounting guidance that would require the lease to be recognized on the balance sheet. An extrapolation of the findings from the sample of issuers in the Study to the approximate population of active U.S. issuers suggests that there may be approximately $1.25 trillion in non-cancelable future cash obligations committed under operating leases that are not recognized on issuer balance sheets, but are instead disclosed in the notes to the financial statements. [Footnote omitted.]

The Board noted in the basis for conclusions in Update 2016-02 that the report "recommended that changes be made to the existing lease accounting requirements to ensure greater transparency in financial reporting and to better address the needs of users of financial statements."

Many of the criticisms associated with previous leases guidance related to the accounting for operating leases in the financial statements of lessees, and the Board's main focus in developing the leases standard was to address those concerns. As a result, the Board decided not to fundamentally change lessor accounting in Topic 842. However, some changes were made to lessor accounting requirements to (1) conform and align that guidance with the lessee guidance and other areas within generally accepted accounting principles (GAAP), such as Topic 606, *Revenue from Contracts with Customers,* and Topic 610, *Other Income,* (2) remove leveraged leases guidance and real-estate specific accounting requirements, and (3) change the definitions of sales-type and direct-finance leases.

The leases standard was developed under a joint project with the International Accounting Standards Board (IASB). The IASB issued IFRS 16, *Leases,* in January 2016.

As compared with the previous lease accounting guidance, the new leases standard requires that lessees recognize lease assets and lease liabilities for all leases (that is, including operating leases). The FASB decided to adopt a lessee accounting model that distinguishes between two types of leases, classifying leases as operating leases or finance leases in a similar manner to the requirements for distinguishing between operating leases and capital leases in legacy GAAP. By retaining a dual classification model for lessees, the display of lease expense in the income statement is largely unchanged from legacy GAAP. Conversely, the IASB decided to adopt a lessee accounting model in which a lessee accounts for all leases with a term of more than 12 months as finance leases, unless the underlying asset is of low value, in which case it would be accounted for as an off-balance sheet executory contract. In many other respects, including lessor accounting, Topic 842 and IFRS 16 have substantially converged.

Additionally, the leases standard requires that both lessees and lessors disclose key qualitative and quantitative information. The disclosures were intended to improve the understandability of an entity's leasing activities, which is a critical part of the analysis of an entity's financial position and performance.

To support the transition and implementation, the Board and staff assisted stakeholders and proactively sought feedback on implementation and application challenges that arose after the issuance of the standard. Unlike what was done for Topic 606, the FASB did not create a transition resource group (TRG) to address the leases guidance because the Board believed that many of the concepts used in Topic 842 are similar to those used in legacy GAAP. The Board made several targeted improvements and clarifications through additional standard-setting activities to address issues and concerns raised by stakeholders when applying the leases standard.

Stakeholder feedback received during the PIR process observed that implementation support provided by the Board and staff was considered to be effective and efficient. Stakeholders noted that (1) many of the issues raised during implementation related to the transition to the leases standard and the changes to systems and processes rather than the technical application of specific requirements and (2) a TRG might have delayed entities' implementation efforts.

Some stakeholders suggested that the Board develop criteria for determining whether a TRG should be established to be used in future standard setting. Identifying the circumstances in which a TRG is useful for the implementation of a new accounting standard would add transparency to the basis for deciding whether to form a TRG.

Topic 842 Accounting Model

Lessee Accounting

Topic 842 requires that lessees recognize on the balance sheet a liability and a right-of-use asset for all leases.[2] The recognition, measurement, and presentation of expenses and cash flows by a lessee did not significantly change from legacy GAAP. The distinction between finance leases (referred to as capital leases under legacy GAAP) and operating leases was retained, but quantitative bright lines were removed.

For both types of leases, a lessee initially measures a lease liability using the present value of the minimum lease payments. The right-of-use asset is initially measured using the lease liability and adjusted for other items such as initial direct costs, lease incentives, and prepayments.

[2] As an accounting policy, a lessee may elect not to apply the recognition requirements in the leases standard to short-term leases.

The primary subsequent accounting requirements for finance and operating leases are as follows.

1. For finance leases:
   a. Recognize interest on the lease liability separately from amortization of the right-of-use asset in the income statement
   b. Classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows.
2. For operating leases:
   a. Recognize a single lease cost in the income statement
   b. Classify all cash payments within operating activities in the statement of cash flows.

Lessor Accounting

A lessor classifies and accounts for leases as sales-type, direct financing, or operating, depending on the enforceable terms of the contract, which is substantially consistent with legacy GAAP.

Expected Benefits and Costs

The Board expected the following benefits from the leases standard:[3]

1. A more faithful representation of the rights and obligations arising from leases by requiring that lessees (a) recognize the lease assets and lease liabilities that arise from leases in the statement of financial position and (b) disclose qualitative and quantitative information about lease transactions, such as information about variable lease payments and options to renew and terminate leases
2. Improved understanding and comparability of lessees' financial commitments regardless of the manner they choose to finance the assets used in their businesses
3. A closer alignment of the concept of control, as it is used in the definition of a lease and the control principle in both Topic 606 and Topic 810, *Consolidation,* and a clarification of the definition of a lease to address practice issues
4. A closer alignment of the lessor accounting and sale and leaseback transactions guidance and the comparable guidance in Topic 606 and Topic 610
5. Additional information for users about lessors' leasing activities and lessors' exposure to credit and asset risk as a result of leasing
6. Fewer opportunities for entities to structure leasing transactions to achieve a particular accounting outcome on the statement of financial position.

The FASB expected the following costs to be incurred related to applying the new leases standard, which primarily related to the lessee requirements:[4]

1. Compliance costs for preparers:
   a. Costs to educate employees about how to apply the new requirements

[3] From the basis for conclusions in Update 2016-02 (paragraph BC8).

[4] From the basis for conclusions in Update 2016-02 (paragraph BC10).

b. Costs to explain the effects of changes in accounting for leases on an entity's financial statements to users of financial statements
c. Costs to appropriately identify all of leases
d. Costs to implement more robust processes and controls to ensure that entities capture all material leasing activity going forward.

The Board stated that a substantial portion of all entities would be able to apply the new requirements using systems and processes similar to those used in legacy GAAP[5] and stated that once an entity's implementation was completed, the ongoing costs for most entities of providing the information would unlikely be significantly higher than the costs of complying with the accounting model in legacy GAAP.[6]

The Board modified or clarified through additional standard setting certain aspects of the leases standard to reduce implementation challenges and clarify application. Adjustments to the guidance during the Leases PIR process to reduce the expected costs included:

1. An additional transition method that allowed an entity to initially apply the leases standard at the adoption date as opposed to at the beginning of the earliest comparative period presented
2. Two effective date deferrals for nonpublic entities
3. Certain clarifications to improve the operability of the leases standard for lessees
4. Several amendments to preserve financial reporting outcomes of lessors achieved under legacy GAAP.

[5] From the basis for conclusions in Update 2016-02 (paragraph BC11).

[6] From the basis for conclusions in Update 2016-02 (paragraph BC10).

Stage 1: Post-Issuance Date Implementation Monitoring

Overview

As described above, Stage 1 of the Leases PIR process started after the issuance of Update 2016-02 in 2016. During this stage, the staff primarily focused on monitoring implementation efforts and assisting stakeholders with application questions. Those activities continued through 2023 when nonpublic entities had completed their adoption and issued their financial statements.

Shortly after the issuance of the leases standard, most preparer stakeholders communicated that initially applying the lessee requirements of the standard was significantly more difficult than anticipated. Those stakeholders indicated that their ability to adopt the leases standard by its effective date was limited by resource constraints, such as a lack of availability of accounting staff and lease accounting systems that were not ready in time to prepare for adoption. In addition, stakeholders observed that significant effort was needed to gather documentation to apply the requirements of the leases standard, including identifying contracts that are (or contain) leases, documenting and tracking lease terms, and developing reasonable and supportable inputs and judgments.

The Board and staff provided implementation support to entities beginning immediately after the leases standard was issued in response to the feedback about the costs of implementation being higher than expected.

Implementation monitoring and support activities during Stage 1 included individual outreach, group discussions, advisory group meetings, conference presentations, technical inquiries, educational videos and webcasts, educational sessions for regulators, discussions with regulators, and discussions with other standard setters, including ongoing discussions with the IASB and its staff.

As a result of the implementation support activities during this phase, several Updates were issued, including Accounting Standards Update No. 2018-11, *Leases (Topic 842): Targeted Improvements,* which provided an additional transition method that did not require comparative periods to be restated. See Appendix B for a list of Updates issued as part of the Leases PIR process.

Many preparers incurred costs to add accounting personnel and engage third-party consultants and experienced higher audit fees related to implementation efforts. Preparers also noted that some of those costs are ongoing. Those preparer stakeholders acknowledged that recognizing operating leases on the balance sheet brought enhanced rigor to aspects of the leases standard that were relatively unchanged from legacy GAAP, particularly when those aspects did not previously affect the accounting for the lease, resulting in preparers establishing more robust internal controls and processes to comply with the requirements of the leases standard. The level of effort required was amplified for many nonpublic entities whose resources are more limited.

Findings and the FASB's Response

Stakeholder feedback indicated that although the leases standard is operable, simplifications and clarifications were necessary during Stage 1 to improve the standard and, where possible, to reduce the significant costs experienced by preparers when implementing the standard. The Board made certain clarifications and improvements through additional standard setting so that stakeholders can apply the standard as intended, the standard is understandable, and preparers are able to report the information reliably (**PIR Objective 1(c)**).

In response to stakeholder feedback, improvements were made to certain elements of the standard-setting process (**PIR Objective 3**).

Amendments to Provide Clarifications and Targeted Improvements

In large part due to feedback obtained by the Board and staff through proactive monitoring and outreach with stakeholders during Stage 1, the Board identified certain application issues that were significant enough to warrant amending the standard before the initial effective date for public entities in 2019. Specifically, the Board issued amendments to Topic 842 that:

1. Provided an additional (and optional) transition method that allowed entities to apply Topic 842 at an entity's adoption date instead of the beginning of the earliest comparative period presented
2. Provided an optional transition practical expedient that allowed entities to continue applying their current accounting policies for land easements that existed or expired before the entities' adoption of Topic 842
3. Provided a practical expedient that allows lessors to combine each separate lease component and the associated nonlease components into a single component if certain criteria are met. The practical expedient also clarified which Topic (either Topic 842 or Topic 606) applies to the combined components
4. Made several targeted improvements to the lessor requirements in Topic 842 to more closely align the accounting with legacy GAAP
5. Made several narrow-scope improvements to the lessee and the lessor requirements to clarify Topic 842 and to correct unintended outcomes of the guidance.

The Board intended for many of the lessor accounting requirements to be substantially unchanged from legacy GAAP. However, in addition, an objective of Topic 842 was to more closely align the lessor requirements with revenue recognition guidance in Topic 606 and Topic 610. Stakeholders observed that it is challenging to implement accounting requirements that have competing objectives to substantially retain legacy guidance while also aligning with other guidance. Those dual objectives were often in conflict and, in some cases, required additional standard setting by the Board.

Most nonpublic entities adopted the leases standard for fiscal years beginning after December 15, 2021. The Board and the staff consistently engaged with nonpublic entity stakeholders to understand implementation issues and challenges with applying Topic 842, some of which were consistent with the experience of other entities and some of which were specific to those entities. The Board learned that the challenges associated with implementing major Updates, including the leases standard, are often magnified for nonpublic entities and that providing sufficient time for implementation was critical to the successful implementation of the leases standard, particularly because other significant Updates had been issued around the same time. The Board also heard feedback about specific areas of the guidance for which simplification or clarification through additional standard setting would enable nonpublic entities to implement and apply the leases standard more efficiently.

Specifically, the Board issued amendments to Topic 842 specific to nonpublic entities that:

1. Deferred the effective date twice
2. Permit nonpublic entity lessees to use a risk-free rate instead of the incremental borrowing rate by class of underlying asset, rather than at the entity-wide level

3. Provided a practical expedient permitting nonpublic entities to use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, how to classify and account for that lease.

Improvements to the Standard-Setting Process

The Leases PIR process provided the Board with timely feedback to improve the standard-setting process in the following areas.

Systems and Process Assumptions

During the development of the leases standard, lessee preparer stakeholders provided feedback that lessees would be able to apply the guidance in the leases standard, initially and on an ongoing basis, using systems and processes similar to those used to apply legacy GAAP. That feedback was an important consideration for the Board when deciding on certain fundamental aspects of the lessee model, including the following:

1. Retaining a dual classification and accounting model for operating and finance leases
2. Initial and subsequent measurement of the lease liability and right-of-use asset for both types of leases
3. Disclosure requirements
4. Modified retrospective approach for transition
5. Effective date.

There was a significant gap between what was communicated to the Board about the adequacy of existing systems and processes and the actual experiences of lessee preparers upon implementing the leases standard. Stakeholders generally looked to purchase new software and were faced with limited software availability and functionality and a general lack of resources to support implementation. Entities developed more robust systems and processes to apply fundamental concepts of the leases standard even though many of those concepts were largely unchanged from legacy GAAP. The new lease model also required new systems and processes for amortizing the right-of-use asset for operating leases.

In addition, preparer feedback underestimated the additional costs incurred for entities to fully and accurately identify and validate their population of leases and lease provisions and incorporate those items, including disclosure of information that may not have previously been part of their accounting systems and processes into their accounting systems and processes.

In the future, the standard-setting process should carefully weigh stakeholder feedback about the expected costs of applying a new comprehensive recognition and measurement model with the expected benefits. A particular focus should be on the need and availability of software solutions, as well as processes to incorporate new information into accounting systems and processes.

Transition Guidance

When issued, the leases standard required a modified retrospective transition method, which included detailed transition requirements and provided several practical expedients. Under that transition method, an entity would have initially applied the new leases standard at the beginning of the earliest period presented in the financial statements. The Board decided on this approach, in part, based on preparer feedback that this transition method along with detailed transition guidance would enable them to adopt the leases standard in a cost-effective manner with relatively limited changes to systems, while balancing the information about comparative period information provided to investors. In contrast, the IASB permitted entities to initially apply IFRS 16 as of the adoption date instead of the beginning of the earliest comparative period presented.

Stakeholder feedback provided during the PIR process indicated that the modified retrospective transition method was challenging to apply and added significant cost and complexity to implement the standard. It also was noted that the detailed transition requirements and the various transitional alternatives and practical expedients, while intended to be helpful in easing the burden of transition, resulted in complexity by permitting numerous accounting alternatives to initially apply the lessee requirements with financial reporting effects that are expected to require detailed tracking for years beyond the adoption date.

In the future, the standard-setting process should consider whether the transition alternatives create inherent complexity for stakeholders in evaluating the effect of implementation of a new standard, including the effects of multiple transition options and the expected benefits and expected costs of the transition requirements.

Effective Dates

In response to stakeholder feedback about the effective date of the leases standard (and feedback about other standards), the staff implemented a new process to better anticipate the length of time that it will take for a final standard to be issued and applied and better evaluate how that timing affects the selection of the effective date. The list of factors that the Board considers when setting a standard's effective date include:

1. Urgency for new guidance
2. Relationship between release date and interim and/or fiscal year-ends
3. Complexity of new guidance
4. Moving from legacy GAAP that required the disclosure of information to a new comprehensive recognition and measurement model
5. Amount of time needed to update information systems and processes
6. Amount of time needed to engage third-party experts and to implement the new guidance
7. Amount of time needed to modify accounting before initial application
8. Effective dates of other Updates
9. Transition method.

The new process also changed the timing of when the Board deliberates and decides the effective dates to be closer to the final issuance of a standard.

Converged Standard Setting

In 2006, the FASB and the IASB initiated a joint project to develop converged leases accounting requirements. The objective of that joint project was to improve the financial reporting of leasing activities considering criticism that the legacy lessee accounting for leases failed to meet the needs of investors. The project included the consideration of both lessee and lessor accounting requirements.

Between 2006 and 2016, the Boards collaborated extensively to develop converged lease accounting requirements. Convergence ultimately requires two independent Boards to reach the same accounting conclusion. Convergence ultimately means that each Board has to compromise.

Although the FASB devoted a significant amount of time and effort to develop converged requirements, the Boards diverged in some key areas such as certain aspects of the lessee accounting model. Before the issuance of the leases standard in 2016, one Discussion Paper (lessee only), *Leases: Preliminary Views* (2009), and two Exposure Drafts (lessee and lessor), Exposure Draft, *Leases* (2010), and Exposure Draft, *Leases* (2013), were issued with more than 1,700 comment letters received in total. There were 54 joint Board meetings held during that time with 294 joint Board memos issued.

Attempting to develop a converged leases standard was a complex undertaking, in part, because stakeholders in different jurisdictions provided different feedback about their priorities, particularly around lessee accounting. That feedback eventually resulted in certain fundamental differences between the two standards. Although certain stakeholders indicated that having partially converged lessee and lessor accounting requirements is beneficial, many observed that the lack of convergence is a source of complexity for stakeholders who are required to follow or use both standards. Specifically, the different lessee classification and accounting models often require that investors adjust their analyses for leases that are, or would be, classified as operating leases under Topic 842 to facilitate consistency and comparability. Entities preparing financial statements under both GAAP and IFRS Accounting Standards are required to account for leases under both standards. In addition, nonpublic entities applying GAAP are required to comply with Topic 842, while entities that apply IFRS for Small and Medium-sized Entities do not apply IFRS 16 and, instead, apply guidance similar to the legacy IFRS requirements in IAS 17, *Leases*.

Overall, the FASB devoted a significant amount of time and effort to attempt to develop a globally converged leases standard. The process to develop converged accounting requirements takes a significant amount of additional time and adds cost and complexity to the standard-setting process. Specifically, doing so necessitates additional efforts by stakeholders to determine whether proposed requirements and the resulting financial reporting are operable and effective. In the future, the standard-setting process should consider those expected benefits and expected costs, and timeliness of standard setting, if the Board contemplates deliberating standards jointly with the IASB.

Defining the Objective of a Project

During the development of Topic 842, the Board issued one Discussion Paper and two Exposure Drafts. The accounting models in those exposure documents and the eventual changes in Topic 842 reflected major variations in the project's objective for both lessor and lessee accounting. For example:

1. The objective of the Discussion Paper in 2009 was to take a "fresh" approach to lessee accounting under a right-of-use accounting model. A lessee would have recognized a lease liability and a related right-of-use asset for all leases, measured as the present value of both fixed and variable lease payments. Lessor accounting was not addressed in this consultation document.

2. The first Exposure Draft, issued in 2010, further developed the right-of-use accounting model for lessees in the Discussion Paper and proposed that lessors change their accounting to a dual model in which a lessor would recognize a lease receivable for all leases and, depending on the lessor's exposure to the risks and benefits of the underlying asset, the lessor would either (a) derecognize a portion of the underlying asset or (b) continue to recognize the underlying asset and recognize a performance obligation liability.
3. The second Exposure Draft, issued in 2013, proposed a new approach to the model for both lessees and lessors based on the lessee's level of consumption of the economic benefits embedded in the underlying asset.

The length of time to complete the active deliberations, the turnover of FASB members during that period, and limited stakeholder agreement with the Board's objectives throughout the project meant that vastly different financial reporting outcomes were pursued in the Exposure Drafts compared with the eventual changes in Topic 842.

The significant accounting changes proposed in those Exposure Drafts for both the lessee and lessor accounting models were transformative to lease accounting. For some stakeholders, it was unclear what objective the Board set out to achieve in those Exposure Drafts and how the proposals responded to the shortcomings that investors and other stakeholders had identified with legacy GAAP.

Furthermore, the multiple exposure documents affected the overall timing of standard setting and raised challenges in evaluating stakeholder feedback. For example, preparer feedback may have been influenced by the view that the proposal was less onerous than a prior Exposure Draft.

Since the issuance of Topic 842, new processes have been implemented at the staff and Board levels to better define the objective of a project during the research phase and to obtain stakeholder input on the objective and potential solutions earlier within a project.

Stage 2: Post-Effective Date Evaluation of Expected Costs and Expected Benefits

Overview

Stage 2 of the Leases PIR process began after the adoption of Topic 842 by public entities in 2019. The staff primarily focused on understanding the costs and benefits of the leases standard and monitoring its ongoing application. The PIR activities under Stage 2 concluded in October 2025 when the Board held its last public Board meeting on the Leases PIR process.

The main activities during Stage 2 included providing ongoing support through responding to technical inquiries; soliciting feedback from stakeholders through advisory group meetings, outreach discussions, surveys, and two public roundtables on the costs, benefits, and implementation challenges of the leases standard; reviewing academic literature, including co-hosting the Accounting for an Ever-Changing World conference; and continuously communicating with the IASB and its staff on each Board's progress on their PIR, including public joint Board meetings to discuss PIR updates in June 2018, July 2019, November 2020, November 2022, June 2024, October 2024, and October 2025.

Findings and the FASB's Response

Throughout Stage 2 of the Leases PIR process, a wide variety of feedback was received. The staff performed related research and provided the Board with periodic updates.

Stakeholder feedback and the staff's research indicated that the leases standard generally accomplished its stated purposes. Specifically, the leases standard addresses the issues that it was intended to address and provides investors with decision-useful information.

Several implementation and ongoing application issues were raised after issuance that had not been anticipated during the Board's deliberations. Generally, the Board did not anticipate significant questions about guidance that, at the time, it believed was largely unchanged from legacy GAAP. Implementation support from the Board and the staff aided stakeholders in managing those issues, and stakeholders also benefitted from discussion groups among large practitioners and industry groups during the implementation period. While the Board will continue to consider whether additional improvements can be made to the leases standard, the leases standard is operable and does not result in significant unexpected changes to financial reporting or operating practices or significant unanticipated consequences (**PIR Objective 1(a)–(e)**).

Stakeholder feedback also indicated that the benefits are consistent with what the Board considered. However, stakeholder feedback indicates that the initial and ongoing costs of the leases standard are significantly higher than the Board considered and stakeholders expected, primarily because entities generally needed new systems and processes to account for operating leases on the balance sheet and many brought off-system leases into the accounting records (**PIR Objective 2(a) and (b)**).

Benefits and Costs Evaluation

In Stage 2 of the Leases PIR process, the staff gathered evidence about the benefits and costs of Topic 842 from stakeholders through various events with stakeholders, including advisory group meetings, surveys, group stakeholder meetings, public roundtables, and interviews. The evidence was collected from stakeholders with diverse backgrounds, from varying entity sizes, and from different types of entities and industries.

Stakeholders generally observed that the leases standard achieves its expected benefits. Investors noted that they are generally receiving better information about a lessee's leasing activities. Although feedback from investors on the usefulness of lessees recognizing lease assets and lease liabilities for all leases on the balance sheet was mixed, for many investors the lease assets and lease liabilities is a useful starting point that improves comparability of leases across reporting entities and over time within a reporting entity. Almost all investors indicated that the disclosures provided are an improvement to those provided under legacy GAAP. Investors highlighted that the disclosures of the components of lease cost (that is, fixed, variable, and short-term) and the weighted-average remaining lease term and weighted-average discount rate are useful. Additionally, many academic studies indicate that the lessee requirements in the leases standard provides a more faithful representation of the rights and obligations arising from lease transactions that improves comparability and users' understanding of entities' financial commitments.

While feedback from investors on lessor reporting under the leases standard has been more limited because the financial reporting under the leases standard is largely consistent with that under legacy guidance, investors generally agreed that lessor financial statement information represents the economics of those entities' leasing arrangements.

Although many preparers noted that their financial statements were not materially affected by the leases standard and that they incurred significant costs in adopting the new leases standard and applying it on an ongoing basis, they indicated that they have benefited from the standard in certain ways. Some preparers noted that the implementation of Topic 842 helped them better understand their contracts and leasing activities, including key terms and conditions such as the nature of the asset, the lease term, the payment structure, and options contained in the contract. Some preparers noted that they strengthened internal controls around their leasing practices as part of the implementation process and they are able to better understand their exposure to leases.

Stakeholders noted that the types of implementation costs incurred by lessees to apply the lessee requirements were not aligned with what was communicated by preparers to the Board at the issuance of the leases standard. Stakeholders noted that they incurred unexpectedly high costs to apply the guidance related to aspects of the leases standard that were largely unchanged from legacy GAAP. That is, a reporting entity needed to fully and accurately identify their population of leases and lease terms and incorporate those items into their accounting systems and processes. The most significant implementation costs related to systems, processes and controls, additional personnel, external consultants, and audit costs. In addition, stakeholders noted that the extent of those costs was significant, especially for the industries in which leasing activity is most significant and for nonpublic entities and entities with limited resources. Some lenders to nonpublic entities commented that significant time has been spent educating relationship managers and other banking professionals about how the leases standard will affect borrowers' financial statements. However, most investors did not experience significant costs in understanding the lessee information resulting from the leases standard when compared with that from legacy GAAP.

Stakeholders noted that certain costs persisted beyond the transition period. The primary ongoing costs raised by stakeholders related to maintaining and updating systems and processes, additional personnel, and external resources. Stakeholders also acknowledged that, in some cases, there are certain other ongoing costs, such as costs to analyze emerging and complex arrangements that are or contain a lease and to establish related controls. Some nonpublic entity stakeholders observed ongoing costs to manually track information because using lease software is not a reasonable alternative in their circumstances.

Overall, the staff believes that sufficient evidence has been received to indicate that the primary benefit of the leases standard expected by the Board was achieved. Investors and other financial statement users are provided with more useful information about a lessee's leasing activities by requiring that all leases be recognized on the balance sheet and enhanced disclosure of key leasing information. However, evidence suggests that the costs to initially implement the lessee requirements along with the ongoing costs to apply those requirements are significantly higher than the Board expected at issuance, primarily because entities' existing systems and processes were often unable to support accounting for operating leases on the balance sheet and additional resources were needed.

For lessors, the staff believes that sufficient evidence has been received to indicate that investors and other users of financial statements are generally satisfied with the information provided under the leases standard. Evidence indicates that because the lessor accounting requirements were largely unchanged from legacy GAAP (after certain conforming changes were made by the Board through additional standard setting), most lessor entities did not incur significant costs to initially implement the lessor requirements or significant ongoing costs to apply those requirements. However, the staff observes that the Board expended time and effort to provide the necessary clarifications through additional standard setting to facilitate that lessor financial accounting outcomes remained more consistent with those achieved under legacy GAAP.

Application Challenges Identified

While many expected benefits were identified, the leases standard was not expected to eliminate all challenges or judgments in its application. During the Leases PIR process, the staff identified areas of the leases standard that are considered challenging to apply. That outreach comprised individual stakeholder meetings, two public roundtables, and discussions at a significant number of advisory group meetings. The staff also reviewed and analyzed annual reports, third-party reports on SEC comment letter trends and restatements, summaries of the American Institute of Certified Public Accountants' peer review reports, and other relevant publications.

During the staff's outreach, preparers, practitioners, and other stakeholders asserted that because of the implementation support provided by the Board and staff, generally, the leases standard is understandable, can be applied as intended, and enables information about an entity's leases to be reported reliably.

The staff identified the following lessee and lessor areas of the leases standard that were considered most challenging to apply by stakeholders.

Lessee Accounting

1. Discount rate
2. Recognition and measurement
3. Related parties
4. Lease modifications[7]
5. Identification of a lease, including embedded leases
6. Sale and leaseback transactions and built-to-suit transactions[8]
7. Allocating between lease and nonlease components.

Lessor Accounting

1. Recognition and measurement
2. Allocating between lease and nonlease components
3. Interaction with Topic 606 and Topic 610.

Although certain areas within the leases standard were highlighted as challenging by some stakeholders, research indicated that those challenges may also have existed or, in some cases, were more complex under legacy GAAP. The challenges generally resulted from the following factors:

1. Because operating leases are now recognized by lessees on the balance sheet, entities are more closely considering certain areas of the lease accounting guidance, such as the identification of a lease, and the determination of the appropriate discount rate, lease term, and lease payments in order to recognize and measure a lease asset and lease liability.
2. The leases standard substantially revised certain complex areas of lease accounting, including the accounting for lease modifications, sale and leaseback transactions, and built-to-suit transactions. These areas of the leases standard generally require significant judgment in application.

Broadly, stakeholder feedback received during the Leases PIR process indicated that no significant changes are needed to the underlying lessee and lessor accounting models in Topic 842. However, some nonpublic entity stakeholders indicated that the Board should consider whether certain areas of the lessee model can be further simplified. The Board will work with the Private Company Council (PCC) and nonpublic entity stakeholders to identify further improvements in this area as needed.

The staff has included a summary of each of these areas identified by stakeholders below.

Lessee Accounting

Discount Rate

Topic 842 requires that a lessee use the rate implicit in the lease whenever that rate is readily determinable for classifying and accounting for its leases. If that rate is not readily determinable, a lessee uses its incremental borrowing rate. A nonpublic entity lessee is permitted to use a risk-free discount rate instead of its incremental borrowing rate. Because the rate implicit in the lease is a lessor-specific rate that is usually not readily determinable by a lessee, a lessee often uses its incremental borrowing

[7, 8] The challenges identified for this area are also applicable for lessor accounting.

rate. *Incremental borrowing rate* is defined in the Master Glossary as "the rate of interest that a lessee would have to pay to borrow on a collateralized basis over a similar term an amount equal to the lease payments in a similar economic environment." The definition of incremental borrowing rate in legacy GAAP did not reference "a collateralized basis," and a lessee was able to use an unsecured rate as its incremental borrowing rate.

Stakeholders observed that it is difficult for lessees to determine the incremental borrowing rate when implementing the leases standard. In particular, stakeholders indicated that the incremental borrowing rate is more closely scrutinized under the leases standard than under legacy GAAP because all leases are now required to be recognized on a lessee's balance sheet. Under legacy GAAP, a lessee often could substantiate that a lease should be classified as an operating lease without performing a present value calculation and, thus, without determining the incremental borrowing rate (for example, by comparing the undiscounted sum of its lease payments with the fair value of the leased asset at the inception of a lease). Stakeholders also indicated that requiring a lessee to determine and substantiate a secured borrowing rate, which was not previously required, involved additional costs for establishing repeatable processes for determining that rate.

Stakeholders generally observed that after developing repeatable processes for determining the incremental borrowing rate upon implementing the leases standard, the ongoing costs and complexities related to making that determination were reduced.

The leases standard originally permitted nonpublic entity lessees to use a risk-free rate instead of the incremental borrowing rate as an entity-wide election for all of a nonpublic entity's leases. Many nonpublic entity stakeholders indicated that nonpublic entity lessees were reluctant to use the risk-free rate election for all leases. Those stakeholders observed that at the time that nonpublic entities were implementing the leases standard, a risk-free rate (for example, a U.S. Treasury rate) was low compared with the average incremental borrowing rate. Therefore, nonpublic entity stakeholders were concerned that using the risk-free rate election for all leases would result in recognizing lease liabilities and right-of-use assets that could be significantly greater than those recognized using the incremental borrowing rate. Furthermore, those stakeholders observed that a lower discount rate could cause leases that otherwise would be classified as operating leases to be classified as finance leases. In response to that feedback, the Board amended the risk-free rate election to allow nonpublic entity lessees to make the election by class of underlying asset.

Recognition and Measurement

Stakeholder feedback on the lessee recognition and measurement requirements was largely related to specific elements of the accounting guidance. The primary topics raised by stakeholders related to accounting for shipping and installation costs, the right-of-use asset impairment requirements, the interaction of the requirements with business combination accounting, and the accounting for lease incentives. Discussions with stakeholders indicate that practice has generally been able to develop acceptable applications of the guidance for those topics. Additionally, the staff observed that the number of questions related to those topics has decreased over time as stakeholders have continued to apply the lessee recognition and measurement requirements in Topic 842.

Related Parties

The leases standard requires that leases between related parties be classified and accounted for in the same manner as all other leases on the basis of the legally enforceable terms and conditions. Nonpublic entity stakeholders (mostly private entities) cited concerns that determining the legally enforceable terms and conditions of a common control arrangement to determine whether a lease exists and, if so, accounting for that lease is often difficult and costly. Those stakeholders observed that determining the enforceable terms and conditions in common control arrangements often presents unique challenges, even when the terms and conditions are written. Private company stakeholder feedback highlighted that it is typical for private company common control leases to have short lease terms (for example, one year), even in situations in which the commonly controlled lessee makes significant leasehold improvements with an estimated useful life that far exceeds the lease term. Those stakeholders were concerned that amortizing leasehold improvements over a period shorter than the estimated useful life of the improvements may result in financial reporting that does not faithfully represent the economics or the common control nature of those improvements.

In response to that feedback, the Board provided nonpublic entities with a practical expedient to use the written terms and conditions of a common control arrangement to determine whether a lease exists and, if so, the classification of and accounting for that lease. Additionally, the Board provided separate requirements for accounting for leasehold improvements associated with common control leases for all entities (that is, including public entities).

Lease Modifications

Accounting for lease modifications under Topic 842 is significantly different from the accounting under legacy GAAP. Under the leases standard (for both lessees and lessors), modifications to existing lease contracts are accounted for as separate contracts if (1) the modification grants the lessee additional rights of use (for example, the right to use an additional asset) and (2) the lease payments increase commensurate with the standalone price for those additional rights. When a modification is a separate contract, it does not affect the accounting for the lease in the original contract. In contrast, if a modification is not considered a separate contract, the existing lease is accounted for as if it was a new lease. Therefore, an entity is required to reassess lease classification and to remeasure the lease as of the effective date of the modification. Doing so requires that an entity update key assumptions such as discount rate, the fair value of the underlying asset (and estimated residual value), and lease term.

Although some stakeholders observed that the lease modifications guidance is more straightforward and clearer than the lease modifications guidance under legacy GAAP, many stakeholders indicated that the guidance can be complex and challenging to apply. Stakeholders observed that the lease modification guidance under the leases standard requires that an entity evaluate multiple steps and, in many cases, update its inputs and assumptions for lease accounting (such as the discount rate), which can be costly or burdensome.

Stakeholders referenced the accounting for a master lease when certain rights were terminated early as particularly challenging under the new modification guidance. The accounting requires that an entity reassess lease classification and adjust accounting for all components of the contract, even those that are not affected by the change. Also, many nonpublic entity stakeholders emphasized that the lease modification guidance is challenging when evaluating simple or straightforward changes to a lease, such as an extension to the lease term that was not covered by a renewal option in the original contract.

During 2021 and through the first half of 2022, the Board and the staff considered whether potential improvements should be made to the lease modification requirements in Topic 842. The Board decided not to pursue improvements to the modification guidance primarily because (1) investors did not indicate that modification accounting should be a high priority for the Board and (2) preparers and practitioners broadly communicated that the modification guidance in the leases standard was a significant improvement from legacy GAAP. The staff observes that questions and concerns about applying the lease modification requirements have decreased over time. However, concerns about the financial reporting outcomes resulting from applying the guidance are raised periodically, and certain nonpublic entity stakeholders observe that the guidance is overly complex. As a result, lease modification accounting may be an area that the Board should monitor for potential consideration.

Separately, during the spring of 2020, many stakeholders communicated that it would be costly and complex for both lessees and lessors to apply the lease modification requirements (in the leases standard and under legacy GAAP) to the significant number of lease contracts for which concessions related to the effects of the global pandemic (COVID-19 pandemic) were made. That is, it could have been challenging for entities to determine whether each existing contract provided enforceable rights and obligations for lease concessions and, if so, whether those concessions were consistent with the terms of a contract or were modifications to the contract. That analysis would have been even more complex considering the government programs being implemented or encouraged that permitted or required forbearance. In response to those concerns, the FASB staff issued a Q&A paper stating that it was acceptable for entities to elect to account for lease concessions related to the effects of the COVID-19 pandemic by applying or not applying the lease modification guidance in the leases standard or under legacy GAAP. Consequently, for concessions related to the effects of the COVID-19 pandemic, an entity would not have to analyze each contract to determine whether enforceable rights and obligations for concessions exist in the contract.

Identification of a Lease, Including Embedded Leases

Topic 842 defines a lease as “a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.” Under the leases standard, an entity has the right to control the use of an identified asset if it has both the right to (1) obtain substantially all of the economic benefits of the identified asset and (2) direct the use of the identified asset. Entities were similarly required to determine whether a contract is or contains a lease under legacy GAAP. A lease was defined under legacy GAAP as “an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time.” Additionally, legacy GAAP provided criteria for determining whether a customer (the lessee) has the right to control the use of the property, plant, and equipment. Although those definitions are similar, it was expected that fewer arrangements would be leases under the leases standard than under legacy GAAP, primarily because the leases standard includes a requirement that a customer has the ability to direct the use of the identified asset.

Stakeholders indicated during the implementation of the leases standard that greater emphasis has been placed on identifying embedded leases as a result of the leases standard because operating lease liabilities and assets are now recognized on a lessee’s balance sheet. That is, a reporting entity needed to fully and accurately identify its population of leases and lease terms and incorporate those items into its accounting systems and processes. Stakeholders noted significant costs and complexities associated with identifying embedded leases and questioned whether additional or amended guidance is needed to reduce the effort of identifying embedded leases. Although the number of questions about identifying whether a contract is or contains a lease has decreased over time, nonpublic entity stakeholders continue to highlight embedded leases as an area that the Board may consider simplifying.

Sale and Leaseback Transactions and Built-to-Suit Transactions

The leases standard significantly changed the accounting for sale and leaseback transactions and built-to-suit transactions. Under the leases standard, a seller (lessee) recognizes the transfer of an asset as a sale and the leaseback as a lease if it is determined that the buyer (lessor) is considered to have obtained control of the asset. In those instances, the buyer (lessor) recognizes the transaction as a purchase and a lease. The seller (lessee) is considered to have transferred control if the leaseback would be classified as an operating lease and, in certain circumstances, the seller does not have an option to repurchase the asset. The leases standard also provides requirements for determining whether a lessee controls an underlying asset that is under construction before the commencement date of a lease (built-to-suit transactions) and did not retain the detailed built-to-suit guidance in legacy GAAP.

Stakeholders generally indicated that the sale and leaseback guidance in the leases standard is an improvement over legacy GAAP. Stakeholders particularly supported the changes to the built-to-suit requirements. However, stakeholders observed that substantial judgment is often still necessary in evaluating this guidance. Additionally, stakeholders cited challenges with determining whether control has been transferred to the buyer (lessor) in certain situations in which the lessee has a repurchase option. Stakeholders also provided feedback about certain specific transactions and scenarios in which sale and leaseback accounting is complex.

The staff observes that judgment is sometimes required for an entity to consider the specific facts and circumstances of a transaction to determine whether control has been transferred to the buyer (lessor) and when applying the built-to-suit requirements in the leases standard. Additionally, the staff's discussions with stakeholders indicate that practice has developed related to the sale and leaseback guidance, including the built-to-suit requirements.

Allocating between Lease and Nonlease Components

Topic 842 requires lessees to allocate the consideration in the contract to the separate lease and nonlease components identified in the contract on a relative standalone price basis. That accounting was similarly required under legacy GAAP. To alleviate operability burdens associated with the lessee allocation guidance, the leases standard allows lessees to elect, by class of underlying asset, to combine lease and nonlease components and account for them as a single lease component. A lessee electing that expedient accounts for all payments, fixed and variable, as lease payments.

Some nonpublic entity stakeholders indicated that allocating the consideration in the contract to the lease components and nonlease components using a relative standalone price basis is often difficult and may result in amounts allocated to the components that do not reflect the economics of the lease contract, particularly when the lease contract involves fixed and variable payments.

The staff observes that the frequency of questions received in this area has decreased over time. The staff's research indicates that many lessees have elected to apply the practical expedient to combine lease and nonlease components and account for them as a single lease component, particularly when the lease component is significantly greater in magnitude than the nonlease component and when the lease classification is not affected.

Lessor Accounting

Recognition and Measurement

Although the Board intended for the lessor accounting requirements to be largely unchanged from legacy GAAP, stakeholders raised several targeted areas that required additional standard setting by the Board to achieve that objective.

Stakeholders requested clarification about whether the Board intended for lessors to account for sales taxes and other similar taxes collected on behalf of third parties as lease revenue (with an offsetting tax expense) or as a pass through to the taxing authority (and, therefore, no income statement recognition). To address that issue, the Board undertook additional standard setting that permits lessors to elect not to evaluate whether certain sales taxes and other similar taxes collected from a lessee, and ultimately remitted to the taxing authority, are lessor costs or lessee costs. An entity that makes that election should not account for those costs as lessor costs.

Stakeholders recommended that the Board clarify whether it intended for certain costs that the lessee pays directly to a third party, such as insurance of which the lessor is the beneficiary and property taxes for which the lessor is ultimately responsible, to be accounted for as lessor costs. The Board clarified through additional standard setting that lessors should exclude from variable payments (and, therefore, from lease revenue) lessor costs such as insurance and property taxes paid by lessees directly to third parties. The Board also specified that costs excluded from the consideration of a contract that are paid by the lessor and reimbursed by the lessee should be accounted for as variable payments (revenue).

Stakeholders requested and the Board issued guidance to reinstate a requirement that existed in legacy GAAP whereby lessors that are not manufacturers or dealers were required to use their cost basis (reflecting any volume or trade discounts that may apply) as the fair value of the underlying asset for classifying and accounting for a lease.

Stakeholders requested that the Board amend the lessor accounting requirements for leases with variable payments that would have been sales-type or direct financing leases for which a selling loss would be recognized at lease commencement. Those stakeholders observed that the loss would be recognized for leases that it expected to be profitable because a lessor is not permitted to estimate variable payments. Stakeholders highlighted that this requirement was a change in practice from legacy GAAP and did not reflect the economics of the transaction. The Board amended the lease classification requirements to specify that lessors should classify and account for a lease with variable lease payments that do not depend on a reference index or a rate as an operating lease if certain criteria are met.

Allocating between Lease and Nonlease Components

Under the leases standard, a lessor is required to separate lease components from nonlease components (for example, common area maintenance services) in a contract. The lease components are accounted for in accordance with the leases standard and the nonlease components in accordance with other Topics (such as Topic 606). A lessor allocates the consideration in the contract to the lease and nonlease components in accordance with the allocation requirements in Topic 606.

Some stakeholders requested that lessors be permitted not to separate nonlease components from the associated lease component, consistent with the practical expedient for lessees. Those stakeholders emphasized that separating nonlease components such as common area maintenance from the associated lease component is a change from legacy GAAP that would have little, if any, meaningful accounting effect, except for presentation and disclosure. Those stakeholders also observed that any allocation method that they would use to separate the components would be judgmental in nature (for example, because of the lack of observable standalone selling prices for each of the components in the contract) and that separating lease and nonlease components does not align with or accurately reflect the economics of how their transactions are negotiated or evaluated by users of their financial statements.

In response to those concerns, the Board amended Topic 842 to permit lessors not to separate nonlease components from the associated lease component if certain criteria are met. The Board specified that under the lessor practical expedient, the lessor would account for the combined component under Topic 606 if the nonlease component (the service component) is the predominant component of the combined component; if not, the lessor should account for the combined component as an operating lease in accordance with Topic 842.

Interaction with Topic 606 and Topic 610

An objective of the leases standard was to more closely align lessor accounting to comparable guidance in Topic 606 and Topic 610.

Stakeholders observed certain differences between the requirements in Topic 606 and the leases standard that affect how amounts are recognized, including the following:

1. The collectibility threshold for recognizing revenue under Topic 606 for contract consideration (lease payments) is different from how the collectibility threshold is applied to leases that are classified as sales-type leases.
2. The existence of a repurchase option generally precludes an entity from recognizing revenue under Topic 606 and Subtopic 610-20, Other Income—Gains and Losses from the Derecognition of Nonfinancial Assets. However, a selling profit may be recognized under the leases standard for a sales-type lease without the transfer of ownership.
3. Variable consideration is estimated under Topic 606, but variable lease payments are not estimated for purposes of applying the leases standard.

Additionally, under Topic 606, a seller does not reassess the collectibility of the consideration in the contract unless a customer's ability to pay the consideration deteriorates significantly. Rather, collectibility of receivables related to revenue transactions is considered a part of measuring credit losses under Topic 326, *Financial Instruments—Credit Losses*. Topic 326 does not apply to operating lease receivables. For operating leases, a lessor determines at lease commencement and on an ongoing basis whether collectibility of the lease payments, plus any amount necessary to satisfy a residual value guarantee provided by the lessee or any other unrelated third party, is not probable. In addition, when a lessor determines that collectibility of lease payments in an operating lease is not probable, including after lease commencement, the amount of revenue recognized is generally limited to the payments received, which requires that the lessor reverse any revenue recognized for which payment has not been received.

Academic Research

In November 2022, the FASB, the IASB, and the Accounting Review (a publication of the American Accounting Association) jointly held the Accounting for an Ever-Changing World conference. At the conference, academics presented research about whether Topic 842 accomplished its stated objective, provided investors with benefits, resulted in implementation or continuing application costs that differed significantly from those anticipated by the Board, or gave rise to unexpected economic consequences. Research papers discussed at the conference addressed economic and financial reporting consequences of the leases standard, leases with variable payments, and lease versus buy decisions.

In addition, as part of the Leases PIR process, following the conference the staff reviewed 33 academic studies undertaken between 2021 and 2025 to assess whether the standard achieved its primary objective and to evaluate associated consequences. Those studies covered a range of topics related to the effect of the leases standard on public entity lessees, such as changes made to their leasing activities, costs incurred to implement the standard, and operability benefits. Additionally, the studies considered the effect of the leases standard on lessee's financial statements for public entities, the decision usefulness of financial information provided to investors, and the effect on certain industries and capital markets.

Generally, the academic studies suggested that Topic 842 provides a more faithful representation of the rights and obligations arising from lease transactions that improve comparability and users' understanding of entities' financial commitments. Since the issuance of the leases standard, there is some evidence that entities have changed the terms of their new operating leases by making leases shorter and/or incorporating more variable lease payments. In addition, despite some stakeholders' concerns that Topic 842 would have adverse economic consequences, in general, academic studies find little evidence of negative economic consequences and some evidence of economic benefits. Certain academic studies observed that entities implemented new systems, updated existing processes, hired new employees, and/or changed their internal controls over financial reporting to comply with Topic 842. For many of those entities, academic research suggests that the changes improved the quality of information available to management, leading to better operating decisions and financial performance. As part of ongoing standard setting, the staff will continue to monitor academic research in this area.

Stage 3: Summary of Research and Reporting

Overview

The staff prepared this report after completing Stages 1 and 2 of the Leases PIR process. It summarizes the activities conducted, information gathered, and actions taken under the Leases PIR process.

Summary of Key Findings

In 2016, the FASB issued Update 2016-02, under a joint project started in 2006 with the IASB. Topic 842 was effective for calendar-year-end public entities in 2019 and for all other calendar-year-end entities in 2022. The leases standard was developed by the Board principally to improve users' understanding about lessees' obligations under lease contracts. The Board sought to provide transparent and economically neutral information about the assets and liabilities that arise from leases, in contrast to what they viewed as the incomplete information provided about leases in legacy GAAP. Lessor accounting was intended to be largely unchanged from legacy GAAP. However, some changes were made to lessor accounting requirements to (1) conform and align that guidance with the lessee guidance and other areas within Topic 606 and Topic 610, (2) remove leverage leases and real-estate specific accounting requirements, and (3) change the definitions of sales-type and direct-finance leases. Although the leases standard does converge with IFRS 16, Leases, in many respects, the Boards diverged in some key areas. While the IASB prescribed a lessee accounting model in which a lessee accounts for most leases as finance leases, except for leases where the underlying asset is of low value, the FASB retained a dual classification model for lessees whereby a lessee accounts for leases differently as operating leases or fiance leases.

Recognizing lease liabilities and lease assets for operating leases resulted in significant costs for many lessee stakeholders beyond what the Board had anticipated when it issued Update 2016-02. Those stakeholders developed or updated systems and processes to apply the guidance. Many lessees strengthened their internal controls around their leasing activities and reevaluated their contracts to determine if they are, or contain, leases, primarily because operating leases are recognized on the balance sheet under the leases standard. A reporting entity needed to fully and accurately identify its population of leases and lease terms and incorporate those items into its accounting systems and processes. The system and process efforts were underestimated because it was assumed that lessees would be able to utilize systems and processes similar to legacy GAAP. That erroneous assumption, which was based on lessee preparer input, was an important consideration for the Board when deciding on many fundamental aspects of the lessee model. The undertaking required to recognize operating leases on the balance sheet was magnified for many nonpublic entities.

Separately, because the lessor accounting requirements were intended to be largely unchanged from legacy GAAP, lessor entities generally did not incur significant costs to initially implement the lessor requirements and did not incur significant ongoing costs to apply those requirements. However, after the issuance of the leases standard, the Board issued several Updates so that the accounting outcomes were more consistent with those under legacy GAAP.

The Board and the staff devoted a significant amount of time to support stakeholders in their implementation of the leases standard. The Board and the staff proactively performed outreach with stakeholders in individual and group meetings and through discussions with FASB advisory groups. In addition, the staff responded to implementation questions through the Technical Inquiry Service.

Several Updates that provided clarifications and targeted improvements were issued during this period to facilitate a high-quality implementation of Topic 842. Those Updates included an additional (and optional) transition method that permitted entities to initially apply the leases standard at the date of adoption instead of the beginning of the earliest comparative period presented and amendments to enable that the financial reporting outcomes achieved by lessors under legacy GAAP remained largely unchanged. In addition, the effective date was deferred twice for nonpublic entities to allow sufficient time for stakeholders to prepare for the adoption. Those activities collectively improved the understandability and operability of the leases standard and supported implementation.

As part of the Leases PIR process, the Board and the staff spent a significant amount of time and effort to understand whether the ongoing costs of applying the leases standard were consistent with the Board's expectation upon the standard's issuance. The Board expected that the ongoing costs for most entities were not likely to be significantly higher than the costs of complying with legacy GAAP. The actual costs of applying the lessee requirements on an ongoing basis are higher than anticipated, which is generally attributable to maintaining and updating systems and processes and continuing to evaluate and account for new and modified lease arrangements. The ongoing costs of applying the lessor requirements are consistent with the Board's expectation when the leases standard was issued.

Investors noted that they are generally receiving better information about a lessee's leasing activities. Although feedback from investors on the usefulness of lessees recognizing lease assets and lease liabilities for all leases on the balance sheet was mixed, for many investors the lease assets and lease liabilities are a useful starting point that improves comparability of leases across reporting entities and over time within a reporting entity. Almost all investors indicated that the disclosures provided are an improvement to those provided under legacy GAAP. The detailed disclosures help investors better understand and analyze an entity's leasing activities and the effect on an entity's financial position and performance. In addition, investors are generally satisfied with the ongoing information provided under the lessor accounting requirements.

Many preparers noted that an ongoing effect of implementing Topic 842 is that it improved their understanding of their leases contracts and strengthened their internal controls around leasing and procurement processes.

Conclusions

On the basis of the activities conducted under the Leases PIR process, the staff reached the following conclusions on Topic 842 and the standard-setting process.

PIR Objective 1: Determine Whether Topic 842 Is Accomplishing Its Stated Purpose

1. It accomplished its primary objective of providing investors with a more faithful representation of the rights and obligations arising from leases by requiring lessees to recognize the lease assets and lease liabilities that arise from all leases on the balance sheet and to disclose key qualitative and quantitative information about lease transactions. Additionally, it more closely aligns the lessor and sale and leaseback accounting with comparable guidance in Topic 606 and Topic 610 and provides investors with decision-useful information about a lessor's leasing activities. Furthermore, it addressed the request from the SEC staff in its *Report On Arrangements with Off-Balance Sheet Implications* to reconsider the accounting guidance for leases (**PIR Objective 1(a)**).

2. It produces decision-useful information reported to and used by investors through its recognition and measurement and improved disclosure requirements (**PIR Objective 1(b)**).
3. It provides understandable and operable guidance that is applied by stakeholders as intended after key implementation support, including subsequent standard setting, was provided by the Board. Additionally, it enables information to be reported reliably (**PIR Objective 1(c)**).
4. For lessees, no significant unexpected changes to financial reporting were identified from applying the leases standard. However, unexpected changes to operating practices were identified because many lessees needed to update or replace existing systems and processes to account for all leases on the balance sheet. For lessors, no significant unexpected changes to financial reporting or operating practices were identified (**PIR Objective 1(d)**).
5. No significant unanticipated consequences resulting from applying the leases standard were identified that were not otherwise considered by the Board (**PIR Objective 1(e)**).

PIR Objective 2: Evaluate Topic 842's Implementation and Continuing Compliance Costs and Related Benefits

1. The nature and magnitude of implementation and ongoing compliance costs associated with the lessee requirements in Topic 842 were significantly greater than the Board's expectations as documented in the basis for conclusions in Update 2016-02. The nature and magnitude of those costs associated with the lessor requirements are generally consistent with what the Board expected as documented in the basis for conclusions in Update 2016-02. (**PIR Objective 2(a)**).
2. The benefits of the leases standard are consistent with what the Board intended (**PIR Objective 2(b)**).

PIR Objective 3: Provide Feedback to Improve the Standard-Setting Process

1. In the future, the standard-setting process should consider improvement in the following areas:
   a. *Systems and process assumptions.* The standard-setting process should carefully weigh stakeholder feedback about the expected costs of applying a comprehensive recognition and measurement model with the expected benefits, including assessing the expected costs related to systems and processes.
   b. *Transition guidance.* The standard-setting process should consider transition provisions and the complexity that they may add to a significant accounting change, including considering the effects of multiple transition options and the expected benefits and expected costs of the transition requirements.
   c. *Converged standard setting.* The benefits and costs, and the timeliness of standard setting, should be considered if the Board contemplates deliberating standards jointly with the IASB in the future.
2. Before the issuance of this Leases PIR report, the standard-setting process was improved in the following areas:
   a. *Effective dates.* Since the issuance of the leases standard, the staff has implemented new processes to better anticipate the length of time that it will take for a standard to be applied and better evaluate how that timing affects the selection of the effective date.
   b. *Defining the objective of a project.* Since the issuance of the leases standard, new processes have been implemented at the staff and Board levels to better define the objective of a project during the research phase and to obtain stakeholder input earlier within a project.

What's Next

Throughout the Leases PIR process, the staff provided periodic updates to the Board on stakeholder feedback and the PIR activities.

Upon concluding the Leases PIR process, the staff has not identified any matters that warrant immediate standard-setting action on Topic 842.

Overall, stakeholder feedback and the staff's research have generally indicated that the leases standard provides investors with decision-useful information. Although certain areas were highlighted as challenging for lessees, given that the lease standard is effective and systems and processes have been developed, most stakeholders do not support any significant changes to the fundamental aspects of the lessee and lessor accounting requirements. In particular, they do not support changes that would affect systems, processes, or internal controls or that would add complexity.

The PCC is currently exploring whether the lessee accounting model can be simplified for private companies to reduce the ongoing costs and complexity associated with applying those requirements.

The Board will monitor feedback from stakeholders on the costs of applying the leases standard and will consider future opportunities to reduce the ongoing costs of the leases standard where appropriate, including through the PCC.

The staff will:

1. Continue to support the application of Topic 842 primarily through the Technical Inquiry Service
2. Assess any need for targeted improvements to Topic 842 arising from stakeholder feedback, future agenda requests, or recommendations of the PCC
3. As part of the general standard-setting process, monitor for emerging practice issues or application issues related to the leases standard that the Board should consider.

In addition, the Board and the staff will continue to incorporate the feedback obtained from the Leases PIR process to improve future standard-setting activities.

Accounting Standards Updates Issued under Leases PIR Process

Accounting Standards Updates: Clarifications and Targeted Improvements

2018

2018-01 | Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842

2018-10 | Codification Improvements to Topic 842, Leases

2018-11 | Leases (Topic 842): Targeted Improvements

2018-20 | Leases (Topic 842): Narrow-Scope Improvements for Lessors

2019

2019-01 | Leases (Topic 842): Codification Improvements

2021

2021-05 | Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments

2021-09 | Leases (Topic 842): Discount Rate for Lessees That are Not Public Business Entities

2023

2023-01 | Leases (Topic 842): Common Control Arrangements

Accounting Standards Updates: Effective Date Deferrals

2019

2019-10 | Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates

2020

2020-05 | Revenue from Contracts with Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities

Excerpt from the U.S. Securities and Exchange Commission (SEC) 2005 Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers

Recommendations Related to Accounting Standards[9]

In 2005, the staff of the SEC issued *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers,* to the United States Congress. The following excerpts from the Report related to leases are included below.

> **Executive Summary (Page 4)**
>
> The Staff recommends that the accounting guidance for leases be reconsidered. The current accounting for leases takes an "all or nothing" approach to recognizing leases on the balance sheet. This results in a clustering of lease arrangements such that their terms approach, but do not cross, the "bright lines" in the accounting guidance that would require the lease to be recognized on the balance sheet. An extrapolation of the findings from the sample of issuers in the Study to the approximate population of active U.S. issuers suggests that there may be approximately $1.25 trillion in non-cancelable future cash obligations committed under operating leases that are not recognized on issuer balance sheets, but are instead disclosed in the notes to the financial statements. [Footnote omitted.]
>
> **Recommendations Related to Accounting Standards (Page 105)**
>
> ***A. Standards on Accounting for Leases***
>
> Lease accounting has been identified repeatedly as an area that should be reexamined by the FASB. [Footnote omitted.] The current "all or nothing" lease accounting guidance is not designed to reflect the wide continuum of lease arrangements that are used, and therefore, it cannot transparently and consistently reflect the varying economics of the underlying arrangements. In addition, the Staff is aware that sophisticated users, such as credit-rating agencies, often adjust balance sheets in their work so they can analyze companies as if all leases were reflected on the balance sheet. A project on lease accounting would be consistent with several of the goals described above in Section V.

[9] Section VI of the SEC's 2005 Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 On Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers includes recommendations for changes in accounting and reporting standards. The full report can be found here.

The lease accounting standards rely extensively on bright lines, greatly increasing the potential for similar arrangements to be portrayed very differently. Indeed, for a lessee, the accounting can flip between recording no assets and liabilities at lease inception to recording the entire leased asset and entire loan price with only a very small change in economics. As discussed previously, the bright line tests have served to facilitate significant structuring of leases to obtain particular financial reporting goals. The extensive structuring further erodes the effectiveness of the standards.

Some have suggested that lease accounting should focus on contractual cash inflows and outflows [Footnote omitted] in determining the amount of assets and liabilities to record on entities' balance sheets. Lease accounting methods based on cash flows would generally require both parties in lease agreements to report their economic interests in the leased assets as well as assets and/or liabilities related to payments mandated by the lease agreement. The FASB, as part of a group of standard setters known as the G4+1, [Footnote omitted] has considered, in some depth, such approaches in the past. [Footnote omitted.] The Staff believes that these approaches, among others, remain worthy of further consideration.

In suggesting that the FASB should undertake a project to reconsider the standards for accounting for leases, the Staff does not mean to suggest that such a project would be simple. Leases can have many different terms, including contingent rents, optional extensions, penalty clauses, purchase options, and others that each will require consideration in any project. The challenges in developing an approach that considers each of these terms in a conceptually consistent way are not insignificant. Furthermore, it is likely that a project on lease accounting would generate significant controversy; many issuers see leasing as an attractive form of financing asset acquisition in part because leases can be structured so as to avoid recording debt. For these reasons, a project on lease accounting would also likely take a significant amount of time as well as necessitate a substantial commitment of FASB staff resources. Nonetheless, the Staff believes that the potential benefits in terms of increased transparency of financial reporting would be substantial enough to justify the time and effort required.

The project to reconsider the accounting for leases may be most effective if conducted as a joint project with the International Accounting Standards Board ("IASB"). The IASB's standards are widely used outside of the United States. In an area as pervasive as leasing, it would be beneficial to have similar accounting standards be used around the world to the greatest extent possible.